Supreme Court, U. S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III, Petitioner,

v.

MARK PAUL FELSEN, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

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JULY 10, 1978

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IN THE

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OCTOBER TERM, 1978

NO. ____

G. GARVIN BROWN, III, Petitioner,

v.

MARK PAUL FELSEN, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Petitioner G. Garvin Brown, III respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of

Appeals for the Tenth Circuit entered in this proceeding on April 14, 1978.

OPINION BELOW

The opinion of the Court of Appeals, and Findings, Conclusions and Order of the Bankruptcy Court for the District of Colorado, are not reported, and appear in the Appendix hereto. No opinion was rendered by the District Court for the District of Colorado. The Order of the District Court affirming the Order of the Bankuptcy Court also appears in the Appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Tenth Circuit was entered on April 14, 1978 affirming the order of the District Court for the District of Colorado and this petition for a writ of certiorari was filed within ninety (90) days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether Section 17(c)(2) of the Bankruptcy Act [11 U.S.C. § 35(c)(2)] confers upon the bankruptcy court exclusive jurisdiction to determine the dischargeability of debts under Section 17(a)(2) and 17(a)(4) [11 U.S.C. § 35(a)(2) and (a)(4)], and allows the court in making its determination to look behind the face of a state court judgment.

2. Whether the bankruptcy court may admit and consider evidence extrinsic to the state court record in order to ascertain the dischargeability of the debt.

3. Whether a state court judgment silent on its face as to dischargeability is thereby res judicata on the dischargeability of the debt in bankruptcy.

STATUTORY PROVISIONS INVOLVED

United States Code, Title 11

§ 35. Debts Not Affected by a Discharge.

(Also referred to as § 17 of the Bankruptcy Act, as amended.)

The verbatim text of 11 U.S.C. § 35 is set forth in the Appendix hereto.

STATEMENT OF THE CASE

The jurisdiction of the district court was invoked because a question arises under the Bankruptcy Act, as amended.

In June, 1975, the Jefferson Bank & Trust ("the Bank") commenced an action against Respondent and Petitioner in state court, the District Court in and for the County of Jefferson, State of Colorado ("the State Court").

The Bank's claims against the Respondent were based on the non-payment of certain debts owed by the Respondent to the Bank. The Bank's claim against Petitioner was based on a guaranty executed by the Petitioner in favor of the Bank, guaranteeing payment of the Respondent's indebtedness to the Bank. Petitioner filed an answer to the Bank's

complaint containing affirmative defenses to the Bank's claim and stating in pertinent part:

> 3. This Defendant [Petitioner] was induced to sign such guaranty by misrepresentations and nondisclosures of material facts by the other defendants hereto [the Respondent and his company Le Mans Motors]
> . . . .

Thereafter, Petitioner filed an Amended Answer with a Crossclaim, which specifically incorporated by reference the Answer. The Crossclaim against the Respondent was a claim for indemnity based on the guaranty. Although not asserted as a separate crossclaim, the issue of fraud by the Resondent was raised on the face of the Answer and the Amended Answer by specific incorporation.

Not only do the pleadings in the State Court record contain clear and unequivocal allegations of fraud, but the deposition of the Respondent taken in the State Court proceedings is riddled with admissions of fraud in connection with the transaction

underlying this lawsuit between the Resondent and Petitioner. (R. Vol. III, Exhibit A, Vol. IA, pp. 61-62, 71-75, 79; Vol. I-B, pp. 19-20, 36, 41-42, 75-76, 78-79, 111)[1] . Shortly after this deposition occurred, the Respondent entered into a stipulated judgment for the full amount claimed against him by Petitioner in the State Court action and the State Court entered judgment based on the stipulation ("the Judgment"). The State Court was thus relieved of the necessity of inquiring into the merits of any of the allegations of the lawsuit. Nor did it have to determine any issue of fact or law pertaining to that suit, including the nature of the obligation or its dischargeability. No evidentiary record was made in the State Court.

In or about January, 1976, one month after Judgment entered in the State Court, the Respondent filed his petition in bankruptcy. Thereafter, Petitioner

---

1. References are to the Record filed herein.

commenced an action in Bankruptcy Court pursuant to Part VII of the Bankruptcy Rules, seeking a determination that the debt owed by Respondent to Petitioner, evidenced by the Judgment, was not dischargeable on the grounds that the debt was for money obtained by false pretenses within the meaning of § 17(a)(2) of the Bankruptcy Act, as amended [11 U.S.C. § 35(a)(2)], for conversion of the property of another within the meaning of § 17(a)(2) of the Bankruptcy Act, as amended, [11 U.S.C. § 35(a)(2)], and for fraud, embezzlement, misappropriation or defalcation while acting as an officer or a fiduciary within the meaning of § 17(a)(4) of the Bankruptcy Act, as amended [11 U.S.C. § 35(a)(4)]. The Respondent answered and moved for summary judgment on the ground that the Judgment contained no finding of fraud on its face, and was therefore res judicata on the issue of dischargeability.

The Respondent's motion for summary judgment was granted. The Findings, Conclusions and Order of the Bankruptcy

Court makes note of the fact that fraud was raised as an issue in the State Court case and that no factual determination was made by the State Court. Appendix p. 24, infra. The Bankruptcy Court granted the motion for summary judgment holding that, because the Judgment did not state on its face, and examination of the State Court record did not indicate conclusively, that it was based upon fraud, the debt was dischargeable. Appendix p. 25, infra. The State Court Judgment was res judicata on the character of the liability and therefore its dischargeability under § 17 of the Bankruptcy Act, as amended. (11 U.S.C. § 35).

The District Court affirmed the determination of the Bankruptcy Court as did the United States Court of Appeals for the Tenth Circuit.

REASONS FOR GRANTING THE WRIT

1. THE DECISION OF THE TENTH CIRCUIT CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS AS TO THE PROPER

INTERPRETATION AND APPLICATION OF 11 U.S.C. § 35 (§ 17 OF THE BANKRUPTCY ACT, AS AMENDED)

Section 35(c)(2) of Title 11 places in the bankruptcy court the exclusive jurisdiction to determine the issue of dischargeability with respect to claims for fraud and claims allegedly arising from willful and malicious conversion of property.

The Tenth Circuit here has held that where a debt sought to be discharged in bankruptcy has been reduced to judgment in state court, the judgment and record of that proceeding are determinative of the nature of the obligation in a subsequent bankruptcy proceeding.

In so holding, the Tenth Circuit directly conflicts with the interpretation of 11 U.S.C. § 35 recently asserted by the Fourth Circuit in In re Pigge, 539 F.2d 369 (1976). The Fourth Circuit interprets 11 U.S.C. § 35 to mean that in a proceeding in bankruptcy court to determine the dischargeability of a provable debt

represented by a state court judgment, the bankruptcy court may go beyond the state court judgment and record and inquire into the circumstances surrounding the contracting of the debt on which the judgment was based. In a situation identical to that here, Pigge allows the bankruptcy court, in the exercise of its exclusive jurisdiction, to take evidence dehors the state court record in order to determine the dischargeability of the debt under § 17(a)(2) and (4) [11 U.S.C. § 35(a)(2) and (4)].

The Tenth Circuit makes no attempt to reconcile its interpretation with that of the Fourth Circuit or with those of other Circuits which are in accord with the Fourth. Rather, the Tenth Circuit relies on its earlier decision in In re Nicholas, 510 F.2d 160 (10th Cir.) cert. denied, 421 U.S. 1012 (1975), which was decided and presented to this Court for review prior to the decision in In re Pigge, supra.

Here, the Tenth Circuit states that because the Judgment was by stipulation,

it was not necessary for the State Court to inquire whether there was fraud involved in the transaction, thereby precluding the bankruptcy court from now considering the issue. It is this statement which makes the conflict with Pigge more patent. While in Pigge the suit included claims both in contract for money loaned, and fraud, the Fourth Circuit acknowledged that when the state court ruled in favor of the creditor on the contract claim, the state court did not consider and did not need to consider, the fraud count. In addition, it did not, and indeed had no jurisdiction to, determine the dischargeablity of the debt at issue because the proper forum for this issue was the bankruptcy court.

Pigge follow a long line of decisions in other circuits and district courts which have interpreted 11 U.S.C. § 35 in a manner contrary to the Tenth Circuit. The Ninth Circuit in Martin v. Rosenbaum, 329 F.2d 817 (1964), and more recently in In re Houtman, 568 F.2d 651 (1978), the Third Circuit in In re Johnson, 323 F.2d 574

(1963), and the Second Circuit in Greenfield v. Tuccillo, 129 F.2d 854 (1942) have expressly held that the bankruptcy court, in the exercise of its exclusive jurisdiction to determine dischargeability of a debt, must determine the nature of the original liability which had been reduced to judgment, and extrinsic evidence may be heard in order to ascertain the nature of the debt. See also Fierman v. Lazarus, 361 F.Supp. 477 (E.D. Pa. 1973); In re Burns, 357 F.Supp. 176 (D. Kan. 1972).

Thus, the Tenth Circuit's determination here that the Bankruptcy Court is bound by the State Court Judgment as to the character of the claim and therefore its dischargeability squarely collides with the decisions of other circuits.

2. THE DECISION BELOW RAISES SIGNIFICANT AND RECURRING PROBLEMS OF CONSIDERABLE PRACTICAL IMPORTANCE IN THE ADMINISTRATION OF THE BANKRUPTCY ACT AND THE JUDICIAL SYSTEM IN THE UNITED STATES.

The Tenth Circuit's opinion in this case reflects a policy determination that has ramifications for all holders of commercial paper pursuing their claims against potential bankrupts, and there are compelling reasons why a definitive interpretation of 11 U.S.C. § 35 by this Court should be provided. The interpretation of 11 U.S.C. § 35 articulated by the Tenth Circuit creates a jurisdictional conflict between state courts and bankruptcy courts and raises important issues of federal jurisdiction and procedure. Litigants, lower federal courts and state courts are urgently in need of the assistance of this Court in understanding the policy and application of 11 U.S.C. § 35.

The 1970 amendments to 11 U.S.C. § 35 added subsection (c), Appendix p. 31, infra, the interpretation of which is at issue here. The legislative history explicitly states that the objective of this amendment was that a single court, to wit, the bankruptcy court, would pass upon the question of dischargeability of particular claims. H. Rep. No. 91-1502

91st Cong., 2d Sess. 2 (1970) U.S. Code Cong. & Admin. News 1970 p. 4156. It would be the exclusive arbiter of dischargeability with respect to claims for fraud and claims arising from willful and malicious conversion of property. The decision of the Tenth Circuit ignores the specific mandate of the 1970 amendments when it holds that a state court judgment silent on its face as to dischargeability or grounds for entry is still controlling as to the nature of the obligation, and therefore its dischargeability.

The position of the Tenth Circuit has widespread implications for creditors holding commercial paper, such as notes or guaranties, and drastically alters the way they must pursue collection. The interpretation of 11 U.S.C. § 35 adopted by the Tenth Circuit forces the creditor while pursuing his claim in state court to divine the future, and the possibility of the debtor's bankruptcy, and to make certain that every judgment arising from a state court proceeding rests squarely on fraud, rather than on a breach of

contract. This reduces the incentive of a commercial creditor to settle a case and stipulate to judgment, forces the creditor to proceed on, and forces the court to try, issues of fraud because of the possibility of a future bankruptcy. Thus, even though a claim for breach of contract is uncontested, the parties must proceed on an essentially superfluous claim of fraud in order to protect against a discharge in a future bankruptcy.

Contrarily, the interpretation by the Tenth Circuit provides a wily defendant with a judicially sanctioned means of circumventing 11 U.S.C. § 35(a); he need only default or agree to a judgment in state court on any ground but fraud, and then rush into bankruptcy. This rule forces creditors to crowd the courts' already busy dockets with litigation which is in essence preventive maintenance, rather than the resolution of immediate disputes.

Although the Tenth Circuit appears to recognize the role of the bankruptcy court as the adjudicator of the federal issue of

nondischargeability, in actuality it is relying on the states and federal district courts to make that determination. The nature of the indebtedness is the critical determination for purposes of dischargeability and the Tenth Circuit rule transfers that determination to the state court, leaving to the bankruptcy court merely the formal application of U.S.C. § 35 to the state court judgment. Consequently, the Tenth Circuit treats the failure of the state court to enter judgment on nondischargeable grounds as a bar to the creditor pursuing nondischargeability in bankruptcy court, ignoring the exclusive jurisdiction of the bankruptcy court over this issue. However, the particular facts pertaining to 11 U.S.C. § 35(a)(2) or (4) may not be raised in the state court since they would not be necessary to obtaining judgment on commercial instruments. Such facts become relevant only after a bankruptcy is pending and only on the issue of dischargeability. Such facts have no bearing on whether or not one party is indebted to another and

the state court is not directly focusing on the issue of dischargeability.

The interpretation of the Tenth Circuit ignores the plain meaning of 11 U.S.C. § 35(c)(2) in favor of effectuating what to it appears to be a desireable policy of limiting the scope of review of a state court judgment by the bankruptcy court.

The state courts, at least in Colorado, are currently unwilling to take up the additional claims as the Tenth Circuit determination would have them do. In Schwartz v. Blue, ___ Colo.App. ___, 573 P.2d 941 (1977), the Colorado Court of Appeals, reiterated that the 1970 amendments gave to the bankruptcy court exclusive jurisdiction to determine whether a particular debt is nondischargeable because of fraud, false pretenses or malicious and willful acts of the bankrupt. Those factors are not passed upon by the state court.

Because the state courts will not make such a determination, and because the Tenth Circuit has stated that the

bankruptcy courts need not make that determination independently from the state judgment, a creditor is effectively denied an opportunity to have the true nature of the obligation determined.

The deep division over the policy enunciated by the Tenth Circuit and the Fourth Circuit needs the attention and resolution by this Court. The practice of limiting a suit on commercial paper to breach of contract, even though other claims may be available, is widespread. Even the courts will attempt to dispose of cases on this ground and leave undecided other issues in the interest of judicial economy. Such a practice underscores the need for a thorough examination of the problem by this Court. The resolution of this question will have immediate importance beyond the Petitioner here, and will affect and guide the action of all commercial creditors in pursuing their claims.

3. EVEN BY ITS OWN STANDARDS, THE RECORD IN THE STATE COURT AND BEFORE THE BANKRUPTCY COURT CONTAINED EVIDENCE OF FRAUD.

The decision of the Tenth Circuit allows the bankruptcy court to look at the record in the state court proceedings. That record, specifically the deposition of Respondent taken in the State Court proceedings, contains admissions of fraud by Respondent in connection with the transaction between Respondent and Petitioner underlying this lawsuit. The Tenth Circuit completely ignored this evidence in the record. Its failure to consider the evidence of fraud in the State Court record is unwarranted and the correctness of its decision, even under its own interpretation of 11 U.S.C. § 35, is suspect.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Tenth Circuit.

Respectfully submitted,

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Counsel for Petitioner

June 10, 1978

APPENDIX

NOT FOR ROUTINE PUBLICATION

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

NO. 77-2035

In the Matter of:	)	
	)	
MARK PAUL FELSEN	)	
f/d/b/a/ Le Mans	)	
Motors, Inc.	)	Appeal from the
	)	United States
	)	District Court
	)	for
G. GARVIN BROWN, III,	)	the District of
	)	Colorado
Plaintiff-Appellant,	)	(D.C. No.
	)	76-B-56)
vs.	)	
	)	
MARK PAUL FELSEN,	)	
Bankrupt,	)	

)
Defendant-Appellee.)

Submitted: March 6, 1978

on the briefs

Craig A. Christensen and Deanna E. Hickman of Dawson, Nagel, Sherman and Howard, Denver, Colorado, for Appellant.

Alex Stephen Keller of Keller, Dunievitz and Johnson, Denver, Colorado, for Appellee.

Before LEWIS, McWILLIAMS and BARRETT, Circuit Judges.

BARRETT, Circuit Judge.

G. Garvin Brown, III (Brown) appeals from a final order of the District Court affirming the decision of a referee in bankruptcy discharging the debts of Mark Paul Felsen, Bankrupt (Felsen).

The debt owed Brown by Felsen was evidenced by a judgment rendered in a state court proceeding. In January, 1974, Brown executed a guaranty in favor of the Jefferson Bank and Trust (Bank), guaranteeing payment of all indebtedness of Felsen and his company, Le Mans Motors, to a limit of $350,000. Felsen and Le Mans Motors subsequently defaulted on obligations to Bank and Bank instituted an action in state court against Felsen and Le Mans, as debtors, and Brown, as guarantor.

In answer to Bank's complaint, Brown alleged that he had executed the guaranty because he had been "induced to sign such guaranty by misrepresentation and nondisclosures of material facts by defendants hereto." [R., Vol. I, at 26.] Subsequently, Brown filed an amended

answer and a cross-claim wherein he incorporated, by reference, the matters alleged in his original answer and, by cross-claim, prayed for reimbursement of any sums he might be liable for on the guaranty. The state action was not tried inasmuch as the Bank, Felsen and Brown entered into a settlement agreement, which was incorporated into a judgment. The parties' stipulation (agreement) provided for judgment in favor of Bank and against Felsen, Brown and Le Mans Motors, jointly and severally, in the amount due and owing Bank and judgment in favor Brown against Felsen and Le Mans for the same amount. No evidentiary record was made of the state court proceedings because the basis of the judgment was the parties' agreement.

In January, 1976, Felsen filed a petition for voluntary bankruptcy. Brown sought to have the judgment rendered in his favor against Felsen in the state court declared nondischargeable, on the ground that he had become Felsen's

guarantor only by reason of Felsen's fraudulent inducement and misrepresentations. Brown contended that application of Section 17(a)(2) of the Bankruptcy Act, 11 U.S.C. 35, prevented discharge. Felsen asserted, in response, that since there had been no finding of fraud in the state court proceedings, the judgment was res judicata. A stipulated record of the state court proceedings, including the pleadings and judgment, was filed in the bankruptcy proceedings.

The referee allowed the discharge, holding that there had been no showing of fraud in the aforesaid state court proceeding:

> As the judges of this Court have unanimously interpreted those guideliness since pronounced, when a debt has been reduced to judgment in a state court, and the record of that state court proceeding is presented to a Bankruptcy Court, the Bankruptcy Court is bound to apply the results of the state court judgment to a complaint to

> determine the dischargeability of the debt founded upon the state court judgment. Not only is the Bankruptcy Court bound by the state court judgment when the state court record is complete, the Bankruptcy Court is also specifically interdicted by Raley from considering any evidence outside that record. Thus, this case must turn on that record stipulated by the parties.
>
> [R., Vol. I, at 46.]

The referee in bankruptcy rendered his decision on the basis of the stipulated record which revealed no fraudulent activity on the part of Felsen. On appeal to the District Court, the dischargeability of the judgment was affirmed.

On appeal, Brown contends that the referee and the District Court erred in allowing discharge of the judgment debt simply because the judgment and the record from which it arose do not indicate facially that the judgment was based on fraud.

Judgments rendered against a bankrupt are not classified or distinguished from other provable debts and they will be discharged unless they fall within the special exceptions delineated in Section 17(a) of the Bankruptcy Act. 8 Remington on Bankruptcy 3302, at 1522. Section 17 does prevent a bankrupt's debt from being discharged if the debt was obtained as a result of false pretenses or false representations.

I.

Brown argues that the state court record contains allegations and evidence of fraud sufficient to raise the issue of fraud relating to the debt evidenced by the judgment. He urges that this court require that the referee undertake a de novo hearing on this issue. We decline to do so.

In light of the parties' stipulation, it was not necessary for the state court to inquire whether the guaranty had been fraudulently induced. There is no record

in existence regarding the alleged fraud. The sole basis on which Brown can now rely in his assertion that fraud motivated him to execute the guaranty is the self-serving matter contained in his answer to the Bank's complaint. This, and this alone, constitutes the sole reference to any possible fraud in the dealings between Brown and Felsen. There was no mention of any fraudulent inducement problem in the stipulation entered into between the parties. The stipulation was, of course, embodied in the judgment entered in the state court.

Brown is bound by the state court judgment in that a consent decree has the same force and effect as any other judgment and is considered to be a final adjudication on the merits. Securities and Exchange Commission v. Thermodynamics, Inc., 319 F. Supp. 1380 (D. Colo. 1970), aff'd, 464 F.2d 457 (10th Cir. 1972), cert. denied, 410 U.S. 927 (1973). Once it is shown that the parties did, in fact, consent to rendition of a judgment, such a

judgment is deemed to be valid and binding. Hot Springs Coal Co. v. Miller, 107 F.2d 677 (10th Cir. 1939). In the instant case there is nothing in the stipulation indicating that the Brown-Felsen guaranty was induced by fraudulent representations. Parties involved in a consent judgment waive their rights to litigate the issues involved in the case as posed by the pleadings. United States v. Armour and Co., 402 U.S. 673 (1971). Thus, we hold that Brown cannot now raise the issue of fraud. Furthermore, Brown's allegation of fraudulent misrepresentations contained in his answer in the state court proceedings does not adequately raise the issue of fraud for bankruptcy consideration. In addition, his casual answer does not meet the requirements of Rule 9, Colorado Rules of Civil Procedure, that all averments of fraud and the circumstances constituting fraud must be stated with particularity.

There is nothing in this record which indicates that the stipulation reached in

settling the litigation in the state court proceeding between Bank, Brown and Felsen was in any manner induced by fraud. Thus, we must reject Brown's contention that the pleadings raise an issue of fraud. In like manner, we hold that Brown is not entitled to a de novo hearing on the alleged fraud issue.

II.

Brown contends that even if fraud was not adequately raised in the state court proceedings, the question of dischargeability is within the sole province of the Bankruptcy Court and that, accordingly, the state court judgment cannot be held to be res judicata on this issue.

The determination as to whether a debt is the result of a fraudulent transaction is, of course, within the ambit of the Bankruptcy Act. However, in the instance where a debt has been reduced to judgment, a referee in bankruptcy generally will not go beyond the record of the proceedings in

which the judgment was rendered in order to ascertain if discharge will lie:

> Where, however, a liability has been prosecuted to judgment, the record is usually held decisive as to the character of the claim upon which the judgment is founded, and cannot be affected by the introduction of parol evidence except in the case of ambiguity. In order that a judgment based upon a fraudulent representation may be excepted from the operation of a discharge, the record in the action must show that fraud and deceit were the 'gist and gravamen' of the action.

Collier on Bankruptcy, Vol. IA, s 17.16 (4), at 1643-6.

This court has rendered two opinions dealing with the discharge of a judgment creditor in a bankruptcy proceeding. They hold that the record of the proceeding in which a judgment was rendered prior to bankruptcy proceedings will generally control in a subsequent bankruptcy proceeding.

In In re Nicholas, 510 F.2d 160 (10th Cir. 1975), cert. denied, 421 U.S. 1012 (1975), a creditor sued to prevent discharge of a default judgment awarded him in a state court proceeding. The creditor claimed that discharge should not lie, inasmuch as the original liability upon which the judgment was based had been obtained through fraud and false pretenses. In support of his contention the creditor filed an affidavit which contained alleged information that the debtor had, in essence, "cheated" the creditor. This court held that where an examination of the entire record and the judgment does not evidence that the liability was predicated on fraud, the referee in bankruptcy must refuse to permit the judgment creditor to introduce extrinsic evidence to the effect that the liability was, in reality, based on fraud. We there observed:

> The record of the proceedings in the state court clearly indicated that the liability was one for damages arising out of

> breach of contract and not fraud. Under such circumstances, there was no need to resort to extrinsic evidence.
>
> 510 F.2d, at 164.

We again articulated the rule that a state court record and judgment will control in a subsequent bankruptcy action in In re Vickers, an unpublished opinion (No. 76-2175, decided August 19, 1977). We there observed:

> The rule in this circuit is that when a debt sought to be discharged has been reduced to judgment in state court, the nature of the obligation is to be determined on the basis of the record and the judgment in that action. Absent ambiguity as to the nature of the claim, no resort may be had to extrinsic evidence.
>
> Ibid, at 6.

WE AFFIRM.

UNITED STATES COURT OF APPEALS

FOR THE TENTH CIRCUIT

MARCH TERM - April 14, 1978

Before Honorable David T. Lewis, Honorable Robert H. McWilliams and Honorable James E. Barrett, Circuit Judges

IN THE MATTER OF:	)	
	)	
MARK PAUL FELSEN,	)	
	)	
Bankrupt,	)	
	)	
G. GARVIN BROWN, III,	)	J U D G M E N T
	)	No. 77-2035
Plaintiff-Appellant,	)	
	)	(D.C. No.
	)	76-B-56)
vs.	)	
	)	
MARK PAUL FELSEN,	)	
	)	
Defendant-Appellee.	)	

This cause came on for consideration on the record on appeal from the United States District Court for the ----- District of Colorado and was submitted on the briefs at the direction of the court.

Upon consideration whereof, it is ordered that the judgment of that court is affirmed

HOWARD K. PHILLIPS, Clerk

J-3 5/75

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLORADO

G. GARVIN BROWN, III,	)	Civil Action
	)	No. 76-B-56
Plaintiff,	)	
	)	
vs.	)	O R D E R
	)	
MARK PAUL FELSEN,	)	
	)	
Bankrupt.	)	

THIS MATTER comes on this day for hearing on Plaintiff's Petition for Review of a judgment by the Bankruptcy Court determining that the debt from the Bankrupt to the Plaintiff is dischargeable. The parties waived the presence of a court reporter.

The Court having heard the arguments of counsel and being familiar with In re Nicholas, 510 F.2d 160 (Tenth Circuit), and the Court having provided counsel with the case of Teutsch v. Vickers, No. 76-2175, decided August 19, 1977 (Tenth

Circuit), and the Court now being fully advised,

DOTH HEREBY AFFIRM IN ALL RESPECTS the judgment and Order of the Bankruptcy Court herein.

DATED at Denver, Colorado, this 19th day of October, 1977.

/s/ Fred M. Winner
Fred M. Winner
United States District
Judge

UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF COLORADO

In re	)	
	)	
MARK PAUL FELSEN,	)	
Bankrupt.	)	
	)	
G. GARVIN BROWN, III,	)	BANKRUPTCY
	)	
Plaintiff,	)	NO. 76 B 56
	)	
vs.	)	
	)	
Bankrupt,	)	
MARK PAUL FELSEN,	)	
Bankrupt,	)	
	)	
Defendant.	)	

FINDINGS, CONCLUSIONS AND ORDER ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Appearances: Craig A. Christensen,
Attorney for the Plaintiff
Alex Stephen Keller,
Attorney for the Defendant

This matter arises out of a complaint filed by the plaintiff (Brown) seeking to have a debt owed by the Bankrupt defendant (Felsen) declared nondischargeable. The complaint filed in this Court is in three Claims for Relief, the first of which avers that Felsen induced Brown into guaranteeing a loan to Felsen and Felsen's business, LeMans Motors (LeMans), by the Jefferson Bank and Trust (Bank). It is further averred that the inducement which procured Brown's guaranty was based on false representations. Finally, it is set forth that Brown's guaranty was called upon by the bank, and that demand ultimately resulted in the bank's obtaining a judgment against Brown in the amount of $298,000.00. The first claim for relief is concluded upon the assertion that Felsen's fraudulent inducement and its subsequent results amount to the obtaining of money or property by false pretenses or false representations within the meaning of §17a(2) of the Bankruptcy Act.

The second claim for relief avers that the indebtedness to Jefferson Bank and Trust and the indebtedness arising out of the bank's judgment against Brown, and a judgment Brown obtained against Felsen for indemnification were debts created by the willful and malicious conversion of property of another by Felsen. The basis for the claim is an averment that Felsen sold automobiles upon which the Bank had a security interest, and which security interest was subrogated to Brown.

The third claim for relief states that Felsen's auto sales previously complained of, made while Felsen was president of LeMans, created a liability by fraud, embezzlement, misappropriation or defalcation while acting as an officer within the meaning of § 17a(4) of the Bankruptcy Act. On the basis of the three claims for relief, Brown sought judgment declaring that the liabilities of Felsen to Brown arising out of Brown's guaranty of the Bank's loan are not dischargeable.

Felsen answered the complaint by denying every averment except that relating to the entry of the judgment by the Bank against Brown. In addition, three affirmative defenses were presented, only one of which is pertinent. In his third affirmative defense, Felsen stated:

> (T)he Civil Action in the District Court of the State of Colorado, City and County of Denver, (sic) referred to in the Complaint, has been finally concluded and determined. The same is res adjudicata (sic) and no finding of fraud was contained therein.

Subsequent to the filing of the answer, Brown filed a motion seeking to have the Court strike the three affirmative defenses.

For reasons not pertinent to the issues now under consideration, the motion to strike was denied by the Court, and the matter was set for pre-trial conference. The Court ordered that counsel appear at

the pre-trial conference prepared to discuss the applicability of Raley v. Nicholas, 510 F. 2d 160 (10th Cir., 1975).

After the pre-trial conference, counsel for both parties filed a stipulated record of the state court proceedings which contained the pertinent pleadings and the state court judgment. Thereafter, Felsen filed the instant motion for summary judgment relying upon the state court record and the holding in Raley v. Nicholas, supra. After oral argument, it appears to the Court that there are no genuine issues as to any material fact, and that this matter should be decided upon the motion for summary judgment.

Applicability of Raley and its result to the case at issue appears inescapable. While the plaintiff insists that there are factual distinctions present in this case which make Raley inapposite, I cannot agree. Moreover, as I view the situation, I have no choice but to enter judgment in

favor of the defendant declaring the debt in question dischargeable.

Let us first examine the law. No matter what the rule may be in other jurisdictions, in this Circuit the guidelines to be followed in cases of this nature are set forth immutably in Raley. As the judges of this Court have unanimously interpreted those guidelines since pronounced, when a debt has been reduced to judgment in a state court, and when the record of that state court proceeding is presented to a Bankruptcy Court, the Bankruptcy Court is bound to apply the results of the state court judgment to a complaint to determine the dischargeability of the debt founded upon the state court judgment. Not only is the Bankruptcy Court bound by the state court judgment, when the state court record is complete, the Bankruptcy Court is also specifically interdicted by Raley from considering any evidence outside that record. Thus, this case must turn on that record stipulated by the parties.

Examination of the state court record indicates that the action was originally commenced by the Bank against Brown and Felsen as codefendants. The original complaint was based entirely on the nonpayment of certain notes, including the note guaranteed by Brown which gives rise to the instant action. Both defendants answered denying the debt, and Brown raised the affimative defense that he was induced to sign the guaranty by "misrepresentations and nondisclosures of material facts by the other defendants hereto". Brown then filed a cross-claim in which he asserted the theory that if he were held liable on the note to the Bank he was entitled to indemnification from Felsen. After a period of time, the parties in the state court entered into a stipulation for the entry of judgment.

By the terms of the stipulation, Brown conceded liability to the Bank upon the complaint and Felsen conceded liability to Brown upon the cross claim. Apparently without further hearing, the state court

entered judgment against both parties in accordance with the stipulation. Nowhere in the stipulation or in the judgment is it indicated that the judgment entered against Felsen was based upon fraud or anything other than upon Felsen's stipulation that judgment be entered against him. Moreover, examination of the entire state court record indicates to me that the liability resulting in the judgment was not based upon fraud.

The only reference to fraud found in the state court record is the previously quoted affirmative defense. Notwithstanding, the cold record fails to disclose the state court's reliance upon the defense as the basis for the judgment. Since Raley will not permit me to go outside the record, I have no choice but to conclude that the liability sought to be discharged is not of the sort made nondischargeable by any provision of § 17 of the Bankruptcy Act. Accordingly, it is

ORDERED that the motion for summary judgment be and the same is hereby granted, and it is

FURTHER ORDERED that the debt owed by the Bankrupt, Mark Paul Felsen, to G. Garvin Brown, III, arising out of a judgment entered in the District Court in and for the County of Jefferson, State of Colorado, be and the same is hereby determined to be dischargeable.

DATED: December 16, 1976

BY THE COURT:

John P. Moore
Bankruptcy Judge

§35. Dischargeability of debts--Debts not affected by a discharge. (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankrupty: Provided, however, That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or

fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this title: And provided further, That a discharge in bankruptcy shall not release or affect any tax lien; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the

property of another; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; (5) are for wages and commissions to the extent they are entitled to priority under subdivision (a) of section 104 of this title; (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment; (7) are for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; or (8) are liabilities for willful and malicious injuries to the person or property of another other than

conversion as excepted under clause (2) of this subdivision.

(b) The failure of a bankrupt or debtor to obtain a discharge in a prior proceeding under this title for any of the following reasons shall not bar the release by discharge in a subsequent proceeding under the title of debts that were dischargeable under subdivision (a) of this section in the prior proceeding: (1) discharge was denied in the prior proceeding solely under clause (5) or clause (8) of subdivision (c) of section 32 of this title; (2) the prior proceeding was dismissed without prejudice for failure to pay filing fees or to secure costs. If a bankrupt or debtor fails to obtain a discharge in a proceeding under this title by reason of a waiver filed pursuant to section 32(a) of this title or by reason of a denial on any ground under section 32(c) of this title other than clause (5) or clause (8) thereof, the debts provable in such proceeding shall not be released by a discharge granted in any

subsequent proceeding under this title. A debt not released by a discharge in a proceeding under this title by reason of clause (3) of subdivision (a) of this section may nevertheless be dischargeable in a subsequent bankruptcy proceeding.

(c) (1) The bankrupt or any creditor may file an application with the court for the determination of the dischargeability of any debt.

(2) A creditor who contends that his debt is not discharged under clause (2), (4), or (8) of subdivision (a) of this section must file an application for a determination of dischargeability within the time fixed by the court pursuant to paragraph (1) of subdivision (b) of section 32 of this title and, unless an application is timely filed, the debt shall be discharged. Notwithstanding the preceding sentence, no application need be filed for a debt excepted by clause (8) if a right to trial by jury exists and any party to a pending action on such debt has timely demanded a trial by jury or if

either the bankrupt or a creditor submits a signed statement of an intention to do so.

(3) After hearing upon notice, the court shall determine the dischargeability of any debt for which an application for such determination has been filed, shall make such orders as are necessary to protect or effectuate a determination that any debt is dischargeable and, if any debt is determined to be nondischargeable, shall determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof. A creditor who files such application does not submit himself to the jurisdiction of the court for any purposes other than those specified in this subdivision (c).

(4) The provisions of this subdivision (c) shall apply whether or not an action on a debt is then pending in another court and any party may be enjoined from instituting or continuing such action prior to or during the pendency of a proceeding to

determine its dischargeability under this subdivision.

(5) Nothing in this subdivision shall be deemed to affect the right of any party, upon timely demand, to a trial by jury where such right exists.

(6) If a bankruptcy case is reopened for the purpose of obtaining the orders and judgments authorized by this subdivision no additional filing fee shall be required.

Supreme Court, U. S.
FILED
AUG 21 1978
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III, Petitioner,

v.

MARK PAUL FELSEN, Respondent.

PETITIONER'S SUPPLEMENTAL MEMORANDUM

DEANNA E. HICKMAN
DAWSON, NAGEL, SHERMAN
& HOWARD
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COUNSEL FOR PETITIONER

AUGUST 17, 1978

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III, Petitioner,

v.

MARK PAUL FELSEN, Respondent.

PETITIONER'S SUPPLEMENTAL MEMORANDUM

The Third Circuit recently addressed the issue of the res judicata effect of a state court judgment in a subsequent bankruptcy proceeding. In In re McMillan, [1978] 2 Bankr. L. Rep. (CCH) ¶ 66,883 (3d Cir., filed June 21, 1978), the Court considered the dischargeability of a debt,

evidenced by a state court judgment, under § 17 of the Bankruptcy Act, as amended (11 U.S.C. § 35). The Third Circuit carefully analyzed both the law and the underlying policy of 11 U.S.C. § 35 and determined that a state court default judgment, even though expressly based on fraud, did not estop the parties from litigating the issues of fraud and dischargeability in a subsequent bankruptcy proceeding.

The Court of Appeals agreed with the bankruptcy judge's determination that he is

> still bound to ascertain for . . . [h]imself that the elements of an exception to dischargeability established by § 17a(2), have been fully proved by the Plaintiff. This cannot be accomplished by mere reference to the wording of an earlier judgment. [1978] 2 Bankr. L. Rep. (CCH) ¶ 66,883 at 76,858.

This squarely contradicts the position of the Tenth Circuit in this case, that a state court judgment is determinative of the issue of dischargeability.

In McMillan, the Court of Appeals focused on the policy underlying the 1970 amendments to 11 U.S.C. § 35 as well as the significant practical problems raised by the issues presented. Several elements form the basis of its decision. First, the state court action was not "actually litigated." Essential to the applicability of the doctrine of res judicata is that the issue have been actually litigated. A default judgment, or stipulated judgment, involves no determination by the finder of fact and provides no real guidance on the merits of the case to courts which may later have cause to consider the judgment.

Second, the facts and issues peculiar to 11 U.S.C. § 35 would not be determined in a state court proceeding. The 1970

amendments to that section changed the law and vested in the bankruptcy court exclusive jurisdiction to determine the dischargeability of debts falling within 11 U.S.C. § 35(a). Res judicata cannot apply to issues which are outside the jurisdiction of the particular forum. Since a state court cannot bindingly determine dischargeability, it is unlikely that a party would plead the elements required by 11 U.S.C. § 35 in a state court proceeding.

Third, policy considerations should prevent the rigid application of res judicata to default and other similar judgments. Such a rule undermines the purpose of 11 U.S.C. § 35, as well as causes needless litigation. As the Third Circuit stated:

> [G]iving full collateral estoppel effect to all facts necessarily determined by a prior default judgment would in

> bankruptcy court determinations under § 17a(2)--
>
> ". . . necessarily defeat a major federal policy of granting exceptions to discharge only in certain circumstances specified by the Bankruptcy Act. . . .
>
> The court also wishes to point out that creditors should not be encouraged to go into state courts prior to bankruptcy seeking default judgments based on fraud. Such a circumstance would create an injustice greater than that which the 1970 amendments were intended to cure." [1978] Bankr. L. Rep. (CCH) ¶ 66,883 at 76,860.

An additional consideration is the practical one of the courts' own dockets.

In order to protect against the situation this petitioner has encountered, the parties will be forced to raise and have tried superfluous issues in order to protect against a future bankruptcy. The Third Circuit, quoting Professor Moore's treatise, recognized the practical administrative problems inherent in such a situation:

> The defendant in a suit should not be compelled, at his peril, to embark on extensive litigation involving perhaps some minor matters in order to prevent the operation of a judgment which would be held conclusively to have established against him every material fact alleged and not denied in the declaration, so as to preclude him from showing the truth if another controversy should arise between the same parties. [1978] 2 Bankr. L. Rep. (CCH) ¶ 66,883 at 76,860.

These same elements are present in the instant case, yet were apparently ignored by the Tenth Circuit in reaching its conclusion.

The decision in In re McMillan sharply contrasts with the Tenth Circuit's unwavering position that a bankruptcy court is bound by a state court judgment on the character of the claim and hence its dischargeability, and highlights the significant practical problems now facing litigants and the courts in this area.

CONCLUSION

For the reasons set forth herein, and in the Petition for a Writ of Certiorari, a writ of certiorari should issue to review the judgment and opinion of the Tenth Circuit.

Respectfully submitted,

Deanna E. Hickman
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HOWARD
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633 Seventeenth Street
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Counsel for Petitioner

August 17, 1978

Supreme Court, U. S.
FILED
DEC 13 1978
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III,
Petitioner,

— v. —

MARK PAUL FELSEN,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 10, 1978
CERTIORARI GRANTED OCTOBER 30, 1978

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

January 6, 1976 — Felsen filed petition in bankruptcy in the Bankruptcy Court for the United States District Court for the District of Colorado.

March 30, 1976 — Brown's complaint to determine dischargeability filed.

April 6, 1976 — Bankruptcy Court Order discharging bankrupt Felsen.

May 18, 1976 — Felsen filed answer and affirmative defenses to complaint to determine dischargeability.

September 1, 1976 — Brown's motion to strike Felsen's affirmative defenses filed.

October 7, 1976 — Order entered denying Brown's motion to strike Felsen's affirmative defenses.

November 10, 1976 — Felsen filed motion and memorandum for summary judgment with stipulation regarding agreed record and attachments.

December 13, 1976 — Brown's memorandum with exhibit in opposition to motion for summary judgment filed.

December 16, 1976 — Findings, conclusions and order of the Bankruptcy Court filed granting Felsen's motion for summary judgment and determining debt to be dischargeable.

December 27, 1976 — Brown's notice of appeal to the District Court filed.

January 5, 1977 — Brown's designation of record and statement of issues filed.

October 19, 1977 — Order of the United States District Court for the District of Colorado entered affirming the judgment and order of the Bankruptcy Court.

November 16, 1977 — Brown's notice of appeal to the Court of Appeals for the Tenth Circuit filed.

November 28, 1977 — Brown's designation of record on appeal filed.

January 18, 1978 — Brown's motion to District Court to supplement record with exhibit omitted by Clerk filed.

January 19, 1978 — Order entered by District Court granting Brown's motion to supplement record.

April 14, 1978 — Opinion and Judgment of the Court of Appeals for the Tenth Circuit.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

In re: MARK PAUL FELSEN ---------- G. GARVIN BROWN, III, Plaintiff, vs. MARK PAUL FELSEN, Bankrupt, Defendant.	Bankruptcy No. 76-B-56 COMPLAINT TO DETERMINE DISCHARGE- ABILITY Filed March 30, 1976

COMES NOW Plaintiff, G. Garvin Brown, III, by and through his attorneys, Dawson, Nagel, Sherman & Howard, and in support of his complaint to determine dischargeability states, alleges and avers as follows:

FIRST CLAIM FOR RELIEF

1. On or about January 22, 1974, Mark Felsen induced G. Garvin Brown, III to execute a guaranty to Jefferson Bank and Trust, guaranteeing all indebtedness of LeMans Motors and Mark Felsen, with a maximum limit of $350,000.00.

2. Said guaranty was induced by false pretenses and representations, among others, that the guaranty was needed solely because of minor cash flow problems with the LeMans Motors business when in fact Mark Felsen had been selling automobiles out of trust, had been making and issuing false documents of title for Ferrari automobiles, and was otherwise in default to Jefferson Bank and Trust.

3. Subsequent to the execution of the guaranty, Mark Felsen and LeMans Motors, Inc. went into default on their obligations to Jefferson Bank and Trust, litigation ensued,

and a judgment against G. Garvin Brown, III in the amount of $298,000.00 was entered in favor of Jefferson Bank and Trust on the guaranty.

4. In order to satisfy said judgment, G. Garvin Brown, III has entered into an agreement with Jefferson Bank and Trust for the time payment of said judgment and to secure said judgment has deposited stock which he owns in the current market value of approximately $320,000.00 with Jefferson Bank and Trust to secure the judgment.

5. The inducement by Mark Felsen of G. Garvin Brown, III to act as the guarantor for debts of Bankrupt Mark Felsen, the entry of a judgment against G. Garvin Brown, III and the surrender of stock to secure payment of that judgment in a value in excess of $320,000.00 constitutes a liability of Mark Felsen for obtaining property by false pretenses or false representations within the meaning of § 17a(2) of the Bankruptcy Act and is not dischargeable.

WHEREFORE, Plaintiff demands judgment against Defendant Mark Felsen that any amount of money owing from Mark Felsen to G. Garvin Brown, III for indemnification on account of payment by G. Garvin Brown, III of obligations of Mark Felsen or LeMans Motors to Jefferson Bank and Trust on the guaranty above identified be determined not dischargeable and that G. Garvin Brown, III have the costs of this action and such other and further relief as the Court deems appropriate.

SECOND CLAIM FOR RELIEF

6. Plaintiff G. Garvin Brown, III hereby incorporates paragraphs 1 through 5 of the First Claim For Relief as if set forth fully herein.

7. The indebtedness amount to Jefferson Bank and Trust of $298,000.00 for which judgment was entered against G. Garvin Brown, III and judgment in favor of G.

Garvin Brown, III on indemnification was entered against Mark Felsen and LeMans Motors, Inc. was a debt created by the willful and malicious conversion of the property of another in that Mark Felsen sold automobiles upon which Jefferson Bank and Trust had a security interest and to which interest G. Garvin Brown, III is subrogated and entitled.

8. The sale of said automobiles was made possible by Mark Felsen's making and issuing false documents of title for said automobiles and the proceeds from said sale were not paid over to Jefferson Bank and Trust, holder of the security interest, but instead were applied by Mark Felsen to some other use.

WHEREFORE, Plaintiff G. Garvin Brown, III demands that the indebtedness owing from Mark Felsen to him on account of the guaranty by him to Jefferson Bank and Trust of the Bankrupt's debts be determined not dischargeable by reason of the Bankrupt's willful and malicious conversion of property securing that obligation to Jefferson Bank and Trust and Plaintiff demands his costs and such other and further relief as the Court deems appropriate.

THIRD CLAIM FOR RELIEF

9. Plaintiff G. Garvin Brown, III hereby incorporates paragraphs 1 through 8 of the First and Second Claims For Relief as if set forth fully herein.

10. Mark Felsen, during the time period complained of, was president of LeMans Motors and his selling automobiles out of trust and retaining the proceeds constituted the creation of liability by fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity within the meaning of § 17a(4) of the Bankruptcy Act.

WHEREFORE, Plaintiff G. Garvin Brown, III demands that the liabilities of Mark Felsen to Plaintiff arising because of the guaranty to Jefferson Bank and Trust of the Defendant's obligations be deemed not dischargeable and that Plaintiff have his costs and such other and further relief as the Court deems appropriate.

DAWSON, NAGEL, SHERMAN & HOWARD

By CRAIG A. CHRISTENSEN

Craig A. Christensen
2900 First of Denver Plaza
633 Seventeenth Street
Denver, CO 80202 (893-2900)

UNITED STATES DISTRICT COURT, DISTRICT OF COLORADO

ANSWER OF FELSEN

Filed May 18, 1976

[Caption omitted in printing]

COMES NOW the Bankrupt, Mark Paul Felsen, by his attorneys, and in answer to the Complaint to Determine Dischargeability alleges as follows:

1. Defendant bankrupt denies paragraphs 1, 2 and 5 of the First Claim for Relief; admits paragraph 3 thereof; and as to paragraph 4 has insufficient knowledge as to the truth thereof.

2. Defendant incorporates herein his answers to the first claim as applicable and denies paragraphs 7 and 8 of the Second Claim for Relief.

3. Defendant incorporates herein his answers to the First and Second Claims for Relief as applicable, and denies paragraph 10 of the Third Claim for Relief.

FIRST AFFIRMATIVE DEFENSE

By way of a First Affirmative Defense, defendant alleges that this proceeding was not timely instituted.

SECOND AFFIRMATIVE DEFENSE

By way of a Second Affirmative Defense, defendant alleges that he has been discharged in this proceeding.

THIRD AFFIRMATIVE DEFENSE

By way of a Third Affirmative Defense, defendant alleges that the Civil Action in the District Court of the State of Colorado, City and County of Denver, referred to

in the Complaint, has been finally concluded and determined. The same is res adjudicata and no finding of fraud was contained therein.

WHEREFORE, having fully answered, defendant prays that the Complaint be dismissed and the he recover his costs.

KELLER & DUNIEVITZ

By ALEX STEPHEN KELLER

Alex Stephen Keller, #1236
Attorneys for Bankrupt Defendant
950 - 17th St., #1650
Denver, Colorado 80202
255-3601

Defendant's Address:
2166 15th St.,
Denver, Colorado 80202

[Certificate of service omitted in printing]

UNITED STATES DISTRICT COURT, DISTRICT OF COLORADO

FELSEN'S MOTION FOR SUMMARY JUDGMENT WITH ATTACHMENTS

Filed November 10, 1976

[Caption omitted in printing]

COMES NOW the defendant above named, pursuant to Rule 756 of the Bankruptcy Rules, and shows this Court that there is no genuine issue as to any material fact herein and that the defendant is entitled to judgment as a matter of law. The Court is respectfully requested to consider the entire file in this action, including previous pleadings, motions and briefs filed herein, to consider the case of *Raley v. Nicholas,* 510 F 2d 160 (10th Cir., 1975), and the stipulated record of the State Court proceedings hereto attached.

Respectfully submitted,

KELLER, DUNIEVITZ & JOHNSON

By ALEX STEPHEN KELLER

Alex Stephen Keller, #1236
Attorneys for Defendant
950 - 17th St., #1650
Denver, Colorado 80202
255-3601

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

In re MARK PAUL FELSEN	Bankruptcy No. 76-B-56
G. GARVIN BROWN, III, Plaintiff, vs. MARK PAUL FELSEN, Bankrupt, Defendant.	STIPULATION REGARDING AGREED RECORD

IT IS STIPULATED by and between the parties that the attached hereto are true and accurate copies of pleadings between these parties in Civil Action No. 46724 of the District Court of Jefferson County, State of Colorado. A list of said pleadings is as follows:

1. Summons and Complaint.

2. Answer of LeMans Motors, Inc. and Mark Felsen.

3. Answer of G. Garvin Brown, III.

4. Amended Answer of G. Garvin Brown, III.

5. LeMans Motors, Inc. and Mark Felsen's Reply to Cross-Claim.

6. Pre-Trial Statement of G. Garvin Brown, III.

7. Stipulation.

8. Judgment.

Dated this 4th day of November, 1976.

DAWSON, NAGEL, SHERMAN & HOWARD

By CRAIG A. CHRISTENSEN

Craig A. Christensen
2900 First of Denver Plaza
633 Seventeenth Street
Denver, CO 80202 (893-2900)
Attorneys for G. Garvin Brown, III

KELLER, DUNIEVITZ & JOHNSON

By ALEX STEPHEN KELLER

Alex Stephen Keller
1650 Colorado National Bldg.
Denver, CO 80202
Attorneys for Mark Paul Felsen and
LeMans Motors, Inc.

* * *

[Summons omitted in printing]

* * *

IN THE DISTRICT COURT
IN AND FOR THE COUNTY OF JEFFERSON
STATE OF COLORADO

Civil Action No. 46727

Division 3

JEFFERSON BANK & TRUST,
a state bank chartered under the laws of the State of Colorado,
Plaintiff,

v.

LEMANS MOTORS, INC., a Colorado corporation, MARK FELSEN, and G. GARVIN BROWN, III,
Defendants.

COMPLAINT

Plaintiff Jefferson Bank & Trust, by Holland & Hart, its attorneys of record, for a complaint against the above-named defendants states and alleges as follows:

FIRST CLAIM FOR RELIEF

1. Plaintiff Jefferson Bank & Trust is a state bank chartered under the laws of the State of Colorado.

2. Defendant Mark Felsen is a resident of the State of Colorado. Defendant LeMans Motors, Inc. is a corporation organized under the laws of the State of Colorado with its principal place of business in Denver, Colorado. Defendant G. Garvin Brown, III is a resident of the State of California.

3. On or about May 13, 1974 defendant LeMans Motors, Inc. ["LeMans"] executed its promissory note in the amount of $313,171.98 in favor of plaintiff. Said note represented a renewal and consolidation of several smaller notes executed between July of 1973 and April of 1974. A copy of said note is attached hereto as Exhibit 1. Said note is in default and defendant LeMans has failed and refused to honor the demand of plaintiff for payment in full of the principal and accrued interest thereon. Said note provides for recovery by plaintiff of its reasonable attorney's fees, costs, and expenses of re-taking, holding, and disposing of collateral security therefor.

4. On or about June 17, 1974, defendant LeMans executed its promissory note in the amount of $36,404.75 in favor of plaintiff. Said note represented a renewal and consolidation of several smaller notes executed between July of 1973 and April of 1974. A copy of said note is attached hereto as Exhibit 2. Said note is in default and defendant LeMans has failed and refused to honor the demand of plaintiff for the payment in full of the principal and accrued interest thereon. Said note provides for recovery by plaintiff of its reasonable attorney's fees, costs, and expenses of retaking, holding, and disposing of collateral security therefor.

5. On or about October 11, 1974 defendant LeMans executed its promissory note in the amount of $22,523.95 in favor of plaintiff. A copy of said note is attached hereto as Exhibit 3. Said note is in default and defendant LeMans has failed and refused to honor the demand of plaintiff for payment in full of the principal and accrued interest thereon. Said note provides for recovery by plaintiff of its reasonable attorney's fees, costs and expenses of re-taking, holding, and disposing of collateral security therefor.

6. There is presently due and owing to plaintiff from defendant LeMans the amount of $251,347.30 principal, plus $16,656.95 interest through March 28, 1975 on the notes referred to in paragraphs 3 and 4 above. Said notes accrue interest at the rate of $89.52 per day from and after March 28, 1975.

7. There is presently due and owing to plaintiff from defendant LeMans the amount of $22,523.95 principal, plus $1,460.07 interest through March 28, 1975 on the note referred to in paragraph 4 above. Said note accrues interest at the rate of $8.64 per day from and after March 28, 1975.

8. By their terms, all promissory notes described herein were to be payable to plaintiff at its principal office in the City of Lakewood, County of Jefferson, State of Colorado.

SECOND CLAIM FOR RELIEF

1. Plaintiff incorporates herein paragraphs 1 through 8 of its First Claim for Relief as though said paragraphs were set forth herein in full.

2. On or about September 9, 1974 defendant Mark Felsen ["Felsen"] executed his promissory note in favor of plaintiff in the amount of $6,501.50. Said note represented a renewal of an earlier note originally executed February 8, 1973 payable to plaintiff. A copy of said note is attached hereto as Exhibit 4. Said note is in default and defendant Felsen has failed and refused to honor the demand of plaintiff for payment in full of the principal and accrued interest thereon. Said note provides for recovery by plaintiff of its reasonable attorney's fees, costs, and expenses of retaking, holding, and disposing of collateral security therefor.

3. Defendant Felsen signed individually as a comaker, the promissory notes described in paragraphs 3, 4 and 5 of plaintiff's First Claim for Relief.

4. There is presently due and owing to plaintiff from Defendant Felsen the amount of $6,501.50 principal plus $574.22 interest through March 28, 1975 on the note referred to in paragraph 2 above. Said note accrues interest at the rate of $2.67 per day from and after March 28, 1975.

THIRD CLAIM FOR RELIEF

1. Plaintiff incorporates herein paragraphs 1 through 8 of its First Claim for Relief as though said paragraphs were set forth herein in full.

2. Plaintiff incorporates herein paragraphs 2 through 4 of its Second Claim for Relief as though said paragraphs were set forth herein in full.

3. On or about January 22, 1974 defendant G. Garvin Brown, III ["Brown"] executed in Lakewood, Colorado, his Continuing Guaranty guaranteeing repayment to plaintiff of any and all indebtedness of defendant LeMans and defendant Felsen up to a maximum amount of $350,000 principal, plus an additional amount over said $350,000 figure for interest, costs, attorneys' fees, and other expenses incurred in the enforcement of said Continuing Guaranty. Defendant Brown has failed and refused to honor the demand of plaintiff for payment in full of the principal and accrued interest thereon, and said Guaranty is in default. A copy of said Guaranty is attached hereto as Exhibit 5.

WHEREFORE, plaintiff Jefferson Bank & Trust prays for entry of judgment as follows:

1. Against defendants Felsen, Brown and LeMans, jointly and severally, in the amount of $291,988.28 plus interest from and after March 28, 1975 at the rate of $98.16 per day; and

2. In addition to the amount requested in paragraph 1 of this prayer, against defendants Felsen and Brown,

jointly and severally, in the amount of $7,075.72 plus interest from and after March 28, 1975 at the rate of $2.67 per day; and

3. Against defendants Felsen, Brown and LeMans, jointly and severally for plaintiff's costs, attorneys' fees, and other expenses incurred hereunder and for such other and further relief as may to the Court seem proper.

HOLLAND & HART

By RICHARD KOON
Richard M. Koon

By EDWARD M. GILES
Edward M. Giles

500 Equitable Building
730 Seventeenth Street
Denver, Colorado 80202
Phone: 292-9200

Attorneys for Plaintiff

Address of Plaintiff:

7590 West Colfax Avenue
Lakewood, Colorado 80215

SECURED NOTE—SINGLE PAYMENT—(SIMPLE)

SECURITY AGREEMENT
AND
PROMISSORY NOTE

LE MANS MOTORS, INC.	2020 South Broadway Denver, Colorado 80210
Name	Mailing Address

Lakewood, Colorado May 13, 1974 Code_____ No. 05701

ON DEMAND, or if no Demand is made, than on or before

_____ $313,171.98
Due

I, we, or either of us, promise to pay to the order of JEFFERSON BANK & TRUST at its office in Lakewood, Jefferson County, Colorado. On Demand, 19__

the sum of

THREE HUNDRED THIRTEEN THOUSAND
ONE HUNDRED SEVENTY ONE 98/100
Dollars,

with interest at the rate of 13 per cent per year, and in the event of default in the payment of the principal and/or interest of this note, this note shall draw interest at the rate of twelve (12) per cent per year from the date of such default or from the date of maturity. Interest is payable monthly.

To secure the payment of the foregoing indebtedness, and any and all liability, direct, indirect, absolute, contingent, due or to become due, now existing or hereafter arising (all hereinafter called "Obligations") of the undersigned to the holder, the undersigned (hereafter sometimes called "Debtor") grants to the holder (sometimes hereafter called "Secured Party") a security interest in all property and any all additions, accessions and substitution thereto or thereof of the undersigned of any kind or transferred now or at any time or times hereafter assigned, transferred or delivered to or left in or coming into possession, control or custody of bank, whether expressly as collateral security or for any other purpose, and in addition thereto the following:

EXHIBIT 1

Year	Make	MSO	Amount Financed	
~~1974~~	~~Lotus~~	~~1231R~~	~~6,565.00~~	*7-26-74*
1973	Ferrari	14631	19,000.00	
1972	Ferrari	04904	18,000.00	
1972	Ferrari	13771	1,500.00	
1973	Ferrari	14963	19,000.00	
1972	Lamborghini	10190	17,000.00	
~~1971~~	~~Lamborghini~~	~~8226~~ *6-19-74*	~~11,000.00~~	*6-19-74*
1973	Ferrari	15485	19,000.00	
1973	Ferrari	03316	11,500.00	
~~1974~~	~~Lotus~~	~~2883R~~	~~6,049.00~~	*6-3-74*
~~1973~~	~~Lotus~~	~~3103R~~	~~5,000.00~~	*8-14-74*
1974	Lotus	4204R	6,500.00	
~~1974~~	~~Lotus~~	~~4099R~~	~~6,665.00~~	*6-10-74*
~~1973~~	~~Lotus~~	~~3301R~~	~~6,000.00~~	*5-31-74*
~~1973~~	~~Lotus~~	~~3006R~~	~~5,385.00~~	*5-31-74*
~~1973~~	~~Lotus~~	~~3014R~~	~~5,507.98~~	*5-31-74*
1973	Ferrari Dino	03066	10,000.00	
1973	Ferrari Dino	03098	11,000.00	
~~1974~~	~~Lotus~~	~~4116R~~	~~6,700.00~~	*6-3-74*
~~1972~~	~~Lotus~~	~~0141K~~	~~4,800.00~~	*5-21-74*
1973	Ferrari	15747	17,000.00	
1973	Ferrari	16895	20,000.00	
~~1973~~	~~Ferrari Dino~~	~~03064~~	~~13,000.00~~	*9-16-74*
1973	Ferrari	14643	18,000.00	
1973	Ferrari	15359	21,000.00	(G. Garvin Brown)
1973	Ferrari	03970	14,000.00	(G. Garvin Brown)
1973	Ferrari	14911	19,000.00	
			313,171.98	

The Debtor agrees to deliver to the Secured Party additional security should the Secured Party deem itself insecure.

At the option of the Secured Party, all Obligations shall become immediately due and payable without notice or demand upon the occurrence of any of the following events of default: (a) failure of the Debtor, with or without demand or notice, to deliver additional security as above agreed; (b) default in the payment or performance of any liability or obligation of any Debtor, endorser or guarantor of any liability or obligation of any Debtor, to the holder; (c) failure to pay when due any premium on any life insurance

policy held as collateral herefor; (d) death, dissolution, termination of existence, insolvency, business failure, appointment of a receiver of any part of the property of, assignment for the benefit of creditors by, or the commencement of any proceedings under any bankruptcy or insolvency laws by or against, any Debtor, endorser or guarantor hereof. Upon the occurrence of any such event of default, and at any time thereafter, the Secured Party shall have the remedies of a Secured Party under the Uniform Commercial Code. The requirement of reasonable notice of public or private sale shall be met if such notice is mailed, postage prepaid, to the Debtor at the address given below at least five days before the time of sale or disposition. Expenses of retaking, holding, preparing for sale, selling or the like shall include Secured Party's reasonable attorney fees and legal expenses.

The undersigned hereby authorize any attorney at law at any time after this obligation becomes due, to appear for us in any court of record in the State of Colorado or elsewhere, and waive the issuance and service of process and confess a judgment or judgments against the undersigned in favor of the holder of this note for the principal amount of this note, plus interest, together with the costs of any action brought thereon, including a reasonable attorney's fee (in no case less than ten per cent of the principal). Stay of execution is hereby waived and the exemption of personal property from levy and sale on any execution issued is also waived.

Any deposits or other sums at any time credited by or due from the holder to any maker, endorser or guarantor hereof and any securities or other property of any maker, endorser or guarantor hereof in the possession of the holder may at all times be held and treated as collateral security for the payment of this obligation. The holder may apply or set off such deposits or other sums against said liabilities at any time in case of makers, but only with respect to matured liabilities in the case of endorsers or guarantors.

No delay or omission on the part of the holder in exercising any right hereunder shall operate as a waiver of such right or of any other right under this note. A waiver on any one occasion shall not be construed as a bar to or waiver of any such right and/or remedy on any future occasion.

Every maker, endorser and guarantor of this notes waives presentment for payment and notice of dishonor, assents to any extension or postponement of the time of payment or any other in-

dulgence and/or to the addition or release of any other party or person primarily or secondarily liable.

The undersigned will pay on demand all costs of collection and reasonable attorneys' fees, incurred or paid by the holder in enforcing this note on default.

LE MANS MOTORS, INC.

Signature

MARK FELSEN President

MARK FELSEN

Individually By:
Mark Felsen

By _____
Signature

President

FORM 393—66

EXHIBIT 1 (Cont.)

SECURED NOTE—SINGLE PAYMENT—(SIMPLE)

SECURITY AGREEMENT

AND

PROMISSORY NOTE

LE MANS MOTORS, INC.	2020 South Broadway, Denver, Colorado
Name	Mailing Address

Lakewood, Colorado June 17, 1974, ____ Code ____ No. 05719

ON DEMAND, or if no Demand is made, than on or before

on demand $36,404.75 Due

I, we, or either of us, promise to pay to the order of JEFFERSON BANK & TRUST at its office in Lakewood, Jefferson County, Colorado. demand 19____ the sum of

THIRTY SIX THOUSAND FOUR HUNDRED AND FOUR AND 75/100

Dollars,

with interest at the rate of 13 per cent per year, and in the event of default in the payment of the principal and/or interest of this note, this note shall draw interest at the rate of twelve (12) per cent per year from the date of such default or from the date of maturity. Interest is payable monthly.

To secure the payment of the foregoing indebtedness, and any and all liability, direct, indirect, absolute, contingent, due or to become due, now existing or hereafter arising (all hereinafter called "Obligations") of the undersigned to the holder, the undersigned (hereafter sometimes called "Debtor") grants to the holder (sometimes hereafter called "Secured Party") a security interest in all property and any all additions, accessions and substitution thereto or thereof of the undersigned of any kind or transferred now or at any time or times hereafter assigned, transferred or delivered to or left in or coming into possession, control or custody of bank,

EXHIBIT 2

whether expressly as collateral security or for any other purpose, and in addition thereto the following:

~~1974 Ferrari~~	~~7952~~	~~14,847.30~~	*Pd 9-16-74*
1974 Ferrari	7738	14,847.30	
~~1974 Jeep~~	~~J1A177GP26360~~	~~6,710.15~~	*Pd 6-26-74*

The Debtor agrees to deliver to the Secured Party additional security should the Secured Party deem itself insecure.

At the option of the Secured Party, all Obligations shall become immediately due and payable without notice or demand upon the occurrence of any of the following events of default: (a) failure of the Debtor, with or without demand or notice, to deliver additional security as above agreed; (b) default in the payment or performance of any liability or obligation of any Debtor, endorser or guarantor of any liability or obligation of any Debtor, to the holder; (c) failure to pay when due any premium on any life insurance policy held as collateral herefor; (d) death, dissolution, termination of existence, insolvency, business failure, appointment of a receiver of any part of the property of, assignment for the benefit of creditors by, or the commencement of any proceedings under any bankruptcy or insolvency laws by or against, any Debtor, endorser or guarantor hereof. Upon the occurrence of any such event of default, and at any time thereafter, the Secured Party shall have the remedies of a Secured Party under the Uniform Commercial Code. The requirement of reasonable notice of public or private sale shall be met if such notice is mailed, postage prepaid, to the Debtor at the address given below at least five days before the time of sale or disposition. Expenses of retaking, holding, preparing for sale, selling or the like shall include Secured Party's reasonable attorney fees and legal expenses.

The undersigned hereby authorize any attorney at law at any time after this obligation becomes due, to appear for us in any court of record in the State of Colorado or elsewhere, and waive the issuance and service of process and confess a judgment or judgments against the undersigned in favor of the holder of this note for the principal amount of this note, plus interest, together with the costs of any action brought thereon, including a reasonable attorney's fee (in no case less than ten per cent of the principal). Stay of execution is hereby waived and the exemption of personal property from levy and sale on any execution issued is also waived.

EXHIBIT 2 (Cont.)

Any deposits or other sums at any time credited by or due from the holder to any maker, endorser or guarantor hereof and any securities or other property of any maker, endorser or guarantor hereof in the possession of the holder may at all times be held and treated as collateral security for the payment of this obligation. The holder may apply or set off such deposits or other sums against said liabilities at any time in case of makers, but only with respect to matured liabilities in the case of endorsers or guarantors.

No delay or omission on the part of the holder in exercising any right hereunder shall operate as a waiver of such right or of any other right under this note. A waiver on any one occasion shall not be construed as a bar to or waiver of any such right and/or remedy on any future occasion.

Every maker, endorser and guarantor of this notes waives presentment for payment and notice of dishonor, assents to any extension or postponement of the time of payment or any other indulgence and/or to the addition or release of any other party or person primarily or secondarily liable.

The undersigned will pay on demand all costs of collection and reasonable attorneys' fees, incurred or paid by the holder in enforcing this note on default.

LE MANS MOTORS, INC.
MARK FELSEN

Signature

MARK FELSEN

By _____
Signature

Personally

FORM 393—66

EXHIBIT 2 (Cont.)

DFG - 1s

PROMISSORY NOTE

(DIRECT LOAN — INTEREST TO FOLLOW — DISCLOSURES INCLUDED)

Customer Number	Note Number	Face Amount	ANNUAL PERCENTAGE RATE:	Note Date (Mo.Da.Yr.)	Maturity Date (Mo.Da.Yr.)
00-62952	002	$ 22,523.95	14.00	10-11-74	11-11-74

29 — US

SECURITY
Right of Set-off and, in addition,

☒ None

☐ _____

☐ _____
as further described in Security Agreement of even date.

☐ Security Agreement secures future or other debt and covers after-acquired property.

Maker: Name, Address, Zip Code

LE MANS MOTORS INC.
2020 South Broadway
Denver, Colorado 80210

Business Phone

Home Phone

The captions above and below and the names, dates, amounts and other information therein, are defined terms and are hereby incorporated in the note provisions below.

Proceeds		$ 22,523.95
Other Charges:		
Insurance	$ _____	
Official Fees	$ _____	
	$ _____	
Total Other Charges		$ _____
Amount Financed		$ 22,523.95
Finance Charges:		
Interest	$ 267.82	
	$ _____	
FINANCE CHARGE (Total)		$ 267.82
Total of Payments		$ 22,791.77

Maker promises to pay to the order of

JEFFERSON BANK & TRUST
P. O. Box 15008

at its banking house in

Lakewood, Colorado 80215

the Amount Financed with interest on the unpaid balance thereof from the Note Date until paid at the **ANNUAL PERCENTAGE RATE.** Principal and interest shall be payable as follows:

at maturity

Purpose of Loan Business
(Personal, Family, Household, Agricultural, or Business)

In the event of prepayment in full, if the earned Finance Charge at the time of prepayment in less than $15.00, the holder of this note ("holder") may collect said amount (inclusive of earned Finance Charge) as a minimum charge.

EXHIBIT 3

At the option of the holder, the unpaid balance of this note and all other obligations of Maker to the holder, direct or indirect, absolute or contingent, now existing or hereafter arising, shall become immediately due and payable without notice or demand if (a) any payment required by this note is not made when due, or (b) a default or event of default occurs under any loan or security agreement or other instrument executed as security for or in connection with this note, or (c) the holder at any time in good faith believes that the prospect of any payment required by this note is impaired, whether or not such belief is caused by any act or failure to act of any Maker or of any endorser, guarantor or accommodation party of or on this note (hereafter collectively referred to as "any other signer").

Maker and any other signer waive presentment, notice of dishonor and protest and assent to any extension of time with respect to any payment due under this note, to any substitution or release of collateral and to the addition or release of any party. No waiver of any payment or other right under this note shall operate as a waiver of any other payment or right, including right of offset. If the holder enforces this note upon default, Maker or any other signer shall pay, or reimburse the holder for, (a) reasonable expenses incurred in realizing on an Security therefor and (b) if referred to an attorney not a salaried employee of the holder, reasonable attorney's fees not in excess of 15% of the unpaid debt after default or, if allowed by the Colorado Uniform Consumer Credit Code (UCCC), such additional fees as may be directed by the Court.

This note (a) is secured by the Security indicated above, if any, and (b) shall be construed under and governed by the laws of Colorado. If there is more than one Maker, all of the provisions of this note shall apply to each and any of them.

By signing this promissory note, Maker also acknowledges receipt of a copy.

Maker's Signature: LE MANS MOTORS, INC.

MARK FELSEN PRES
Mark Felsen, President

MARK FELSEN
Mark Felsen, Individually

EXHIBIT 3 (Cont.)

Property insurance, if written in connection with this loan, may be obtained by Maker through any person of his choice. Credit Life and Disability Insurance is not required. No charge is made for insurance and no insurance is provided unless the borrower signs the appropriate statement below:

☐ Credit Life Insurance alone costing $_____ for the term of the credit.

☐ Credit Life and Disability Insurance costing $_____ for the term of the credit.

☐

I desire the insurance checked above:

_____ (Date) _____ (Signature)

EXHIBIT 3 (Cont.)

DFG - 1s

PROMISSORY NOTE

(DIRECT LOAN — INTEREST TO FOLLOW — DISCLOSURES INCLUDED)

Customer Number	Note Number	Face Amount	ANNUAL PERCENTAGE RATE	Note Date (Mo.Da.Yr.)	Maturity Date (Mo.Da.Yr.)
00-43192	001	$ 6,501.50	15.00	9-9-74	12-9-74

008 — US

SECURITY
Right of Set-off and, in addition,
☒ None
☐ _____
☐ _____
as further described in Security Agreement of even date.
☐ Security Agreement secures future or other debt and covers after-acquired property.

Maker: Name, Address, Zip Code
FELSEN, Mark
2020 South Broadway
Denver, Colorado 80210

Business Phone _____
Home Phone

The captions above and below and the names, dates, amounts and other information therein, are defined terms and are hereby incorporated in the note provisions below.

Proceeds		$ 6,501.50
Other Charges:		
Insurance	$ _____	
Official Fees	$ _____	
	$ _____	
Total Other Charges		$ ~~6,501.50~~
Amount Financed		$ 6,501.50
Finance Charges:		
Interest	$ 243.14	
	$ _____	
FINANCE CHARGE (Total)		$ 243.14
Total of Payments		$ 6,744.64

Maker promises to pay to the order of **JEFFERSON BANK & TRUST**
P. O. Box 15008
at its banking house in
Lakewood, Colorado 80215
the Amount Financed with interest on the unpaid balance thereof from the Note Date until paid at the **ANNUAL PERCENTAGE RATE**. Principal and interest shall be payable as follows.
at maturity

Purpose of Loan Personal
(Personal, Family, Household, Agricultural, or Business)

In the event of prepayment in full, if the earned Finance Charge at the time of prepayment in less than $15.00, the holder of this note ("holder") may collect said amount (inclusive of earned Finance Charge) as a minimum charge.

EXHIBIT 4

At the option of the holder, the unpaid balance of this note and all other obligations of Maker to the holder, direct or indirect, absolute or contingent, now existing or hereafter arising, shall become immediately due and payable without notice or demand if (a) any payment required by this note is not made when due, or (b) a default or event of default occurs under any loan or security agreement or other instrument executed as security for or in connection with this note, or (c) the holder at any time in good faith believes that the prospect of any payment required by this note is impaired, whether or not such belief is caused by any act or failure to act of any Maker or of any endorser, guarantor or accommodation party of or on this note (hereafter collectively referred to as "any other signer").

Maker and any other signer waive presentment, notice of dishonor and protest and assent to any extension of time with respect to any payment due under this note, to any substitution or release of collateral and to the addition or release of any party. No waiver of any payment or other right under this note shall operate as a waiver of any other payment or right, including right of offset. If the holder enforces this note upon default, Maker or any other signer shall pay, or reimburse the holder for, (a) reasonable expenses incurred in realizing on an Security therefor and (b) if referred to an attorney not a salaried employee of the holder, reasonable attorney's fees not in excess of 15% of the unpaid debt after default or, if allowed by the Colorado Uniform Consumer Credit Code (UCCC), such additional fees as may be directed by the Court.

This note (a) is secured by the Security indicated above, if any, and (b) shall be construed under and governed by the laws of Colorado. If there is more than one Maker, all of the provisions of this note shall apply to each and any of them.

By signing this promissory note, Maker also acknowledges receipt of a copy.

Maker's Signature:

MARK FELSEN
Mark Felsen

EXHIBIT 4 (Cont.)

Property insurance, if written in connection with this loan, may be obtained by Maker through any person of his choice. Credit Life and Disability Insurance is not required. No charge is made for insurance and no insurance is provided unless the borrower signs the appropriate statement below:

☐ Credit Life Insurance alone costing $ —0— for the term of the credit.

☐ Credit Life and Disability Insurance costing $ —0— for the term of the credit.

☐

I desire the insurance checked above:

(Date) (Signature)

EXHIBIT 4 (Cont.)

CONTINUING GUARANTY

TO JEFFERSON BANK & TRUST

(1) For valuable consideration, the undersigned (hereinafter called Guarantors) jointly and severally unconditionally guarantee and promise to pay to JEFFERSON BANK & TRUST (hereinafter called Bank), or order, on demand, in lawful money of the United States, any and all indebtedness of LEMANS MOTORS & MARK FELSEN (hereinafter called Borrowers) to Bank. The word "indebtedness" is used herein in its most comprehensive sense and includes any and all advances, debts, obligations and liabilities of Borrowers or any one or more of them, heretofore, now, or hereafter made, incurred or created, whether voluntary or involuntary and however arising, whether due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined, and whether Borrowers may be liable individually or jointly with others, or whether such indebtedness may be or hereafter become otherwise unenforceable.

(2) The liability of Guarantors shall not exceed at any one time the sum of THREE HUNDRED FIFTY THOUSAND and no/100 Dollars ($350,000.00) for principal, together with all interest upon the indebtedness or upon such part thereof as shall not exceed the foregoing limitation. Notwithstanding the foregoing. Bank may permit the indebtedness of Borrowers to exceed Guarantors' liability. This is a continuing guaranty relating to any indebtedness, including that arising under successive transactions which shall either continue the indebtedness or from time to time renew it after it has been satisfied. This guaranty shall not apply to any indebtedness created after actual receipt by Bank of written notice of its revocation as to future transactions. Any payment by Guarantors shall not reduce their maximum obligation hereunder, unless written notice to that effect be actually received by Bank at or prior to the time of such payment.

(3) The obligations hereunder are joint and several, and independent of the obligations of Borrowers, and a separate action or actions may be brought and prosecuted against Guarantors whether action is brought against Borrowers or whether Borrowers be joined in any such action or actions.

(4) Guarantors authorize Bank, without notice or demand and without affecting their liability hereunder, from time to time to (a) renew, compromise, extend, accelerate or otherwise change the time for payment of, or otherwise change the terms of the indebtedness or any part thereof, including increase or decrease of the rate of interest thereon; (b) take and hold security for the payment of this guaranty or the indebtedness guaranteed, and exchange, enforce, waive and release any such security; (c) apply such security and direct the order or manner of sale thereof as Bank in its discretion may determine; and (d) release or substitute any one or more of the endorsers or guarantors. Bank may without notice assign this guaranty in whole or in part.

EXHIBIT 5

(5) Guarantors waive any right to require Bank to (a) proceed against Borrowers; (b) proceed against or exhaust any security held from Borrowers; or (c) pursue any other remedy in Bank's power whatsoever. Guarantors waive any defense arising by reason of any disability or other defense of Borrowers or by reason of the cessation from any cause whatsoever of the liability of Borrowers. Until all indebtedness of Borrowers to Bank shall have been paid in full, even though such indebtedness is in excess of Guarantors' liability hereunder. Guarantors shall have no right of subrogation and waive any right to enforce any remedy which Bank now has or may hereafter have against Borrowers and waive any benefit of, and any right to participate in any security now or hereafter held by Bank. Guarantors waive all presentments, demands for performance, notices of non-performance, protests, notices of protest, notices of dishonor, and notices of acceptance of this guaranty and of the existence, creation or incurring of new or additional indebtedness.

(6) In addition to all liens upon, and rights of setoff against the moneys, securities or other property of Guarantors given to Bank by law, Bank shall have a lien upon and a right of setoff against all moneys, securities and other property of Guarantors now or hereafter in the possession of or on deposit with Bank, whether held in general or special account or deposit, or for safekeeping or otherwise; and every such lien and right of setoff may be exercised without demand upon notice to Guarantors. No lien or right of setoff shall be deemed to have been waived by any act or conduct on the part of Bank, or by any neglect to exercise such right of setoff or to enforce such lien or by any delay in so doing, and every right of setoff and lien shall continue in full force and effect until such right of setoff or lien is specifically waived or released by an instrument in writing executed by Bank.

(7) Any indebtedness of Borrowers now or hereafter held by Guarantors is hereby subordinated to the indebtedness of Borrowers to Bank; and such indebtedness of Borrowers to Guarantors if Bank re request shall be collected, enforced and received by Guarantors as trustees for Bank and be paid over to Bank on account of the indebtedness of Borrowers to Bank but without reducing or affecting in any manner the liability of Guarantors under the other provisions of this guaranty.

(8) Where any one or more of Borrowers are corporations or partnerships, it is not necessary for Bank to inquire into the powers of Borrowers or the officers, directors, partners or agents acting or purporting to act on their behalf, and any indebtedness made

EXHIBIT 5 (Cont.)

or created in reliance upon the professed exercise of such powers shall be guaranteed hereunder.

(9) Guarantors agree to pay a reasonable attorneys' fee and all other costs and expenses which may be incurred by Bank in the enforcement of this Guaranty.

(10) Any married woman who signs this guaranty hereby expressly agrees that recourse may be had against her separate property for all her obligations under this guaranty.

(11) In all cases where there is but a single Borrower or a single Guarantor, then all words used herein in the plural shall be deemed to have been used in the singular where the context and construction so require; and when there is more than one Borrower named herein, or when this guaranty is executed by more than one Guarantor, the word "Borrowers" and the word "Guarantors" respectively shall mean all and any one or more of them.

IN WITNESS WHEREOF the undersigned Guarantors have executed this guaranty this 22nd day of January, 1974.

G. GARVIN BROWN III

State of Colorado
County of Jefferson } ss.

The foregoing instrument was acknowledged before me this 22nd day of January, 1974, by Garvin Brown III

Witness my hand official seal.

LEAPHA SHACHIL

Notary Public

My commission expires Sept 2, 1974

Form 246

EXHIBIT 5 (Cont.)

DISTRICT COURT, STATE OF COLORADO
FELSEN'S ANSWER TO STATE COURT COMPLAINT

[Caption omitted in printing]

COME NOW the defendants, LeMans Motors, Inc. and Mark Felsen, by their attorneys, Keller & Dunievitz, and in answer to the Complaint allege as follows:

ANSWER TO FIRST CLAIM

These defendants admit paragraphs 1, 2 and 8 and deny paragraphs 3, 4, 5, 6 and 7.

ANSWER TO SECOND CLAIM

These defendants incorporate herein their answers to the first claim as applicable and deny paragraphs 2, 3 and 4.

ANSWER TO THIRD CLAIM

These defendants incorporate herein their answers to the first and second claims as applicable and admits paragraph 3.

WHEREFORE, having fully answered, these defendants pray that the Complaint be dismissed as against them and that they recover their costs.

KELLER & DUNIEVITZ

By ALEX STEPHEN KELLER

Attorneys for Defendants LeMans & Felsen
316 Symes Building
Denver, CO 80202 255-3601

Address of LeMans & Felsen:
2020 So. Broadway
Denver, CO 80210

[Certificate of service omitted in printing]

DISTRICT COURT, STATE OF COLORADO
BROWN'S ANSWER TO STATE COURT COMPLAINT

[Caption omitted in printing]

COMES NOW Defendant G. Garvin Brown, III, by and through his attorneys, Dawson, Nagel, Sherman & Howard, and in answer to Plaintiff's Complaint admits, denies, and alleges as follows:

FIRST CLAIM FOR RELIEF

1. In answer to paragraph 1 of Plaintiff's Complaint, this Defendant admits the allegations therein.

2. In answer to paragraph 2 of the Plaintiff's Complaint, this Defendant admits that he is a resident of the State of California but is without sufficient information to form a belief as to the truthfulness of the remaining allegations of paragraph 2 and therefore denies the same.

3. This Defendant is without sufficient information to form a belief as to the truthfulness of the allegations contained in paragraphs 3, 4, 5, 6, 7, and 8 of Plaintiff's First Claim for Relief and therefore denies the same.

SECOND CLAIM FOR RELIEF

1. This Defendant incorporates by reference his answers to paragraphs 1 through 8 of Plaintiff's First Claim for Relief as though said answers were set forth herein in full.

2. This Defendant is without sufficient information to form a belief as to the truthfulness of the allegations contained in paragraphs 2, 3, and 4 of Plaintiff's Second Claim for Relief and therefore denies the same.

THIRD CLAIM FOR RELIEF

1. This Defendant incorporates herein by reference his answers to paragraphs 1 through 8 of Plaintiff's First Claim for Relief as though said answers were set forth herein in full.

2. This Defendant incorporates herein his answers to paragraphs 2 through 4 of Plaintiff's Second Claim for Relief as though said answers were set forth in full.

3. In answer to paragraph 3 of Plaintiff's Third Claim for Relief, this Defendant admits that his signature appears on Exhibit 5 to Plaintiff's Complaint. This Defendant further admits that he has paid no sums to the Plaintiff but denies that any sums are due and owing. This Defendant denies each and every remaining allegation contained in paragraph 3 of Plaintiff's Third Claim for Relief.

AFFIRMATIVE DEFENSES

As separate and affirmative defenses to the claim of Jefferson Bank & Trust, the defendant G. Garvin Brown, III alleges:

1. This Defendant received no adequate consideration whatsoever from Plaintiff or any other source for the execution of the guaranty upon which he is sued herein.

2. The terms of the guaranty upon which this Defendant is sued are grossly unjust, overreaching, unreasonable and unconscionable insofar as they purport to apply to him.

3. This Defendant was induced to sign such guaranty by misrepresentations and non-disclosures of material facts by the other defendants hereto, which misrepresentations and non-disclosures were known to or under the circumstances should have been known to Plaintiff at the time it accepted the purported guaranty.

4. At the time the Plaintiff requested and this Defendant delivered his purported guaranty, the Plaintiff possessed information concerning the business and financial condition of LeMans Motors, Inc. and Mark Felsen,

which was not known to this Defendant and which was material to the risk which this Defendant understood he would be undertaking as a guarantor to Plaintiff. Plaintiff knew or should have known under the circumstances that such information was unknown to this Defendant and Plaintiff failed to disclose such information to this Defendant.

5. This Defendant was induced to sign such guaranty by misrepresentations and non-disclosures of material facts by the Plaintiff and its agents or employees.

6. The Plaintiff, through its agents and employees represented to this Defendant that care was being taken in the preservation of collateral held by the Bank as security for the underlying obligation and this Defendant relied upon said representations and upon said preservation of the collateral. In fact, said representations were not true and the Plaintiff allowed the collateral to be wasted and dissipated.

7. Plaintiff has not cared for the collateral or performed its obligations in this transaction in a commercially reasonable manner and this Defendant is entitled to a setoff for any amounts of collateral or other assets which were otherwise available in satisfaction of the obligation but were allowed to be wasted or dissipated by the Plaintiff contrary to reasonable standards or to the representations of the Plaintiff to this Defendant.

8. This Defendant is informed and believes that a lengthy period of time elapsed from the time that the Bank's rights as alleged in its Complaint first accrued, but that nevertheless, the Plaintiff failed and refused to enforce its rights as alleged therein. As a proximate result thereof, and in reliance upon the Plaintiff's forbearance as alleged, this Defendant was prejudiced in his ability to seek and obtain adequate indemnification pursuant to existing rights of indemnification which this Defendant

could otherwise have immediately enforced. As a proximate result thereof, the Plaintiff has waived its rights to recover from this Defendant on the guaranty attached to the Complaint.

WHEREFORE, this Defendant, having fully answered Plaintiff's Complaint, prays that the same be dismissed and that the Plaintiff take nothing by way of its Complaint, for costs and for such other and further relief as this Court may deem appropriate.

DAWSON, NAGEL, SHERMAN & HOWARD

H. Clay Whitlow
Craig A. Christensen

By _____

Craig A. Christensen
2900 First of Denver Plaza
633 Seventeenth Street
Denver, CO 80202
893-2900
Attorneys for Defendant
G. Garvin Brown, III

[Certificate of service omitted in printing]

DISTRICT COURT, STATE OF COLORADO
BROWN'S AMENDED ANSWER TO STATE COURT COMPLAINT

[Caption omitted in printing]

COMES NOW Defendant G. Garvin Brown, III, by and through his attorneys, Dawson, Nagel, Sherman & Howard, and submits the following amended answer and cross-claim:

PRELIMINARY

Defendant G. Garvin Brown, III hereby incorporates by reference his previous Answer as if fully set forth herein.

FIRST CROSS-CLAIM

1. Any liability which this Defendant purportedly has to Plaintiff arises out of a guaranty executed by this Defendant on behalf of LeMans Motors, Inc. and Mark Felsen.

2. If judgment is had against this Defendant by Plaintiff, then this Defendant is entitled to be indemnified by LeMans Motors, Inc. and Mark Felsen for the full amount of said judgment, plus the Defendant's costs and expenses.

WHEREFORE, this Defendant demands judgment against LeMans Motors, Inc. and Mark Felsen for indemnification in the amount of any judgment entered in the favor of Plaintiff against this Defendant, for interest, costs, attorney's fees, and such other and further relief as this Court may deem appropriate.

DAWSON, NAGEL, SHERMAN & HOWARD
CRAIG A. CHRISTENSEN

By _____

Craig A. Christensen
2900 First of Denver Plaza
633 Seventeenth Street
Denver, CO 80202 (893-2900)
Attorneys for Defendant G. Garvin Brown, III

[Certificate of service omitted in printing]

DISTRICT COURT, STATE OF COLORADO
FELSEN'S REPLY TO BROWN'S CROSS-CLAIM

[Caption omitted in printing]

COME NOW the defendants, LeMans Motors, Inc. and Mark Felsen, by their attorneys, and deny the allegations of the First Cross-Claim filed by defendant G. Garvin Brown, III.

WHEREFORE, having fully answered, these defendants pray that the First Cross-Claim be dismissed as against them and that they recover their costs.

KELLER & DUNIEVITZ

ALEX STEPHEN KELLER

By _____

Attorneys for Defendants, LeMans and Felsen
316 Symes Building
Denver, CO 80202
255-3601

[Certificate of service omitted in printing]

* * *

[Attachment entitled Pre-trial Statement of G. Garvin Brown, III filed in State Court omitted in printing]

* * *

DISTRICT COURT, STATE OF COLORADO

STATE COURT STIPULATION

[Caption omitted in printing]

Plaintiff Jefferson Bank & Trust, and defendants LeMans Motors, Inc., Mark Felsen, and G. Garvin Brown, III, stipulate and agree that judgment may enter as follows:

1. On plaintiff's complaint, in favor of plaintiff Jefferson Bank & Trust and against defendants LeMans Motors, Inc., Mark Felsen and G. Garvin Brown, III, jointly and severally, in the amount of $298,000, which sum includes principal, interest, expenses, reasonable attorneys fees, and costs, plus interest at the legal rate from and after December 31, 1975.

2. On the crossclaim of defendant G. Garvin Brown, III, in favor of defendant G. Garvin Brown, III, and against defendants LeMans Motors, Inc. and Mark Felsen, in the amount of $298,000, plus interest at the legal rate from and after December 31, 1975.

HOLLAND & HART

Edward M. Giles

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DAWSON, NAGEL, SHERMAN & HOWARD

Craig A. Christensen

By _____
Craig A. Christensen
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Denver, Colorado 80202
893-2900
Attorneys for G. Garvin Brown, III

IN THE DISTRICT COURT
IN AND FOR THE COUNTY OF JEFFERSON
STATE OF COLORADO
Civil Action No. 46727
Division 3

JEFFERSON BANK & TRUST, a state bank chartered under the laws of the State of Colorado,
Plaintiff,

vs.

LEMANS MOTORS, INC., a Colorado corporation,

MARK FELSEN, and
G. GARVIN BROWN, III,
Defendants.

JUDGMENT

THIS MATTER having come before the Court upon the stipulation of all parties, and the Court having read the stipulation and fully considered the matter, it is

ORDERED, ADJUDGED AND DECREED that judgment enter as follows:

1. On plaintiff's complaint, in favor of plaintiff Jefferson Bank & Trust and against defendants LeMans Motors, Inc., Mark Felsen and G. Garvin Brown, III, jointly and severally, in the amount of $298,000, which sum includes principal, interest, expenses, reasonable attorneys fees, and costs, plus interest at the legal rate from and after December 31, 1975.

2. On the crossclaim of defendant G. Garvin Brown, III, in favor of defendant G. Garvin Brown, III and against defendants LeMans Motors, Inc. and Mark Felsen, in the

amount of $298,000, plus interest at the legal rate from and after December 31, 1975.

DATED: December ...., 1975.

/s/ WINSTON W. WOLVINGTON

District Judge

APPROVED:

HOLLAND & HART

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By Craig A. Christensen

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893-2900
Attorneys for Defendant G. Garvin Brown, III

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO

In re MARK PAUL FELSEN, Bankrupt. G. GARVIN BROWN, III, Plaintiff, vs. MARK PAUL FELSEN, Bankrupt, Defendant.	BANKRUPTCY NO. 76 B 56

FINDINGS, CONCLUSIONS AND ORDER ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Filed December 16, 1976

Appearances: Craig A. Christensen, Attorney for the Plaintiff

Alex Stephen Keller, Attorney for the Defendant.

This matter arises out of a complaint filed by the plaintiff (Brown) seeking to have a debt owed by the Bankrupt defendant (Felsen) declared non-dischargeable. The complaint filed in this Court is in three Claims for Relief, the first of which avers that Felsen induced Brown into guaranteeing a loan to Felsen and Felsen's business, LeMans Motors (LeMans), by the Jefferson Bank and Trust (Bank). It is further averred that the inducement which procured Brown's guaranty was based on false representations. Finally, it is set forth that Brown's guaranty was called upon by the bank, and that demand ultimately resulted in the bank's obtaining a judgment against Brown

in the amount of $298,000.00. The first claim for relief is concluded upon the assertion that Felsen's fraudulent inducement and its subsequent results amount to the obtaining of money or property by false pretenses or false representations within the meaning of §17a(2) of the Bankruptcy Act.

The second claim for relief avers that the indebtedness to Jefferson Bank and Trust and the indebtedness arising out of the bank's judgment against Brown, and a judgment Brown obtained against Felsen for indemnification were debts created by the willful and malicious conversion of property of another by Felsen. The basis for the claim is an averment that Felsen sold automobiles upon which the Bank had a security interest, and which security interest was subrogated to Brown.

The third claim for relief states that Felsen's auto sales previously complained of, made while Felsen was president of LeMans, created a liability by fraud, embezzlement, misappropriation or defalcation while acting as an officer within the meaning of § 17a(4) of the Bankruptcy Act. On the basis of the three claims for relief, Brown sought judgment declaring that the liabilities of Felsen to Brown arising out of Brown's guaranty of the Bank's loan are not dischargeable.

Felsen answered the complaint by denying every averment except that relating to the entry of the judgment by the Bank against Brown. In addition, three affirmative defenses were presented, only one of which is pertinent. In his third affirmative defense, Felsen stated:

> (T)he Civil Action in the District Court of the State of Colorado, City and County of Denver, (sic) referred to in the Complaint, has been finally concluded and determined. The same is res adjudicata (sic) and no finding of fraud was contained therein.

Subsequent to the filing of the answer, Brown filed a motion seeking to have the Court strike the three affirmative defenses.

For reasons not pertinent to the issues now under consideration, the motion to strike was denied by the Court, and the matter was set for pre-trial conference. The Court ordered that counsel appear at the pre-trial conference prepared to discuss the applicability of *Raley v. Nicholas,* 510 F. 2d 160 (10th Cir., 1975).

After the pre-trial conference, counsel for both parties filed a stipulated record of the state court proceedings which contained the pertinent pleadings and the state court judgment. Thereafter, Felsen filed the instant motion for summary judgment relying upon the state court record and the holding in *Raley v. Nicholas,* supra. After oral argument, it appears to the Court that there are no genuine issues as to any material facts, and that this matter should be decided upon the motion for summary judgment.

Applicability of *Raley* and its result to the case at issue appears inescapable. While the plaintiff insists that there are factual distinctions present in this case which make *Raley* inapposite, I cannot agree. Moreover, as I view the situation, I have no choice but to enter judgment in favor of the defendant declaring the debt in question dischargeable.

Let us first examine the law. No matter what the rule may be in other jurisdictions, in this Circuit the guidelines to be followed in cases of this nature are set forth immutably in *Raley*. As the judges of this Court have unanimously interpreted those guidelines since pronounced, when a debt has been reduced to judgment in a state court, and when the record of that state court proceeding is presented to a Bankruptcy Court, the Bankruptcy Court is bound to apply the results of the state court judgment to a complaint to determine the dischargeability of the debt founded upon the

state court judgment. Not only is the Bankruptcy Court bound by the state court judgment, when the state court record is complete, the Bankruptcy Court is also specifically interdicted by *Raley* from considering any evidence outside that record. Thus, this case must turn on that record stipulated by the parties.

Examination of the state court record indicates that the action was originally commenced by the Bank against Brown and Felsen as codefendants. The original complaint was based entirely on the non-payment of certain notes, including the note guaranteed by Brown which gives rise to the instant action. Both defendants answered denying the debt, and Brown raised the affirmative defense that he was induced to sign the guaranty by "misrepresentations and non-disclosures of material facts by the other defendants hereto". Brown then filed a cross-claim in which he asserted the theory that if he were held liable on the note to the Bank he was entitled to indemnification from Felsen. After a period of time, the parties in the state court entered into a stipulation for the entry of judgment.

By the terms of the stipulation, Brown conceded liability to the Bank upon the complaint and Felsen conceded liability to Brown upon the cross claim. Apparently without further hearing, the state court entered judgment against both parties in accordance with the stipulation. Nowhere in the stipulation or in the judgment is it indicated that the judgment entered against Felsen was based upon fraud or anything other than upon Felsen's stipulation that judgment be entered against him. Moreover, examination of the entire state court record indicates to me that the liability resulting in the judgment was not based upon fraud.

The only reference to fraud found in the state court record is the previously quoted affirmative defense. Notwithstanding, the cold record fails to disclose the state

court's reliance upon the defense as the basis for the judgment. Since *Raley* will not permit me to go outside the record, I have no choice but to conclude that the liability sought to be discharged is not of the sort made nondischargeable by any provisions of § 17 of the Bankruptcy Act. Accordingly, it is

ORDERED that the motion for summary judgment be and the same is hereby granted, and it is

FURTHER ORDERED that the debt owed by the Bankrupt, Mark Paul Felsen, to G. Garvin Brown, III, arising out of a judgment entered in the District Court in and for the County of Jefferson, State of Colorado, be and the same is hereby determined to be dischargeable.

DATED: December 16, 1976

BY THE COURT:

John P. Moore

Bankruptcy Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

G. GARVIN BROWN, III, Plaintiff, vs. MARK PAUL FELSEN, Bankrupt.	Civil Action No. 76-B-56 ORDER Filed October 19, 1977

THIS MATTER comes on this day for hearing on Plaintiff's Petition for Review of a judgment by the Bankruptcy Court determining that the debt from the Bankrupt to the Plaintiff is dischargeable. The parties waived the presence of a court reporter.

The Court having heard the arguments of counsel and being familiar with *In re Nicholas,* 510 F.2d 160 (Tenth Circuit), and the Court having provided counsel with the case of *Teutsch v Vickers,* No. 76-2175, decided August 19, 1977 (Tenth Circuit), and the Court now being fully advised,

DOTH HEREBY AFFIRM IN ALL RESPECTS the judgment and Order of the Bankruptcy Court herein.

DATED at Denver, Colorado, this 19th day of October, 1977.

Fred M. Winner

Fred M. Winner
United States District Judge

NOT FOR ROUTINE PUBLICATION
UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 77-2035

In the Matter of:

MARK PAUL FELSEN
f/d/b/a/LeMans Motors, Inc.

G. GARVIN BROWN, III,
Plaintiff-Appellant,

vs.

MARK PAUL FELSEN, Bankrupt,
Defendant-Appellee.

Appeal from the United States District Court for the District of Colorado (D.C. No. 76-B-56)

Filed April 14, 1978

Submitted: March 6, 1978
on the briefs

Craig A. Christensen and Deanna E. Hickman of Dawson, Nagel, Sherman and Howard, Denver, Colorado, for Appellant.

Alex Stephen Keller of Keller, Dunievitz and Johnson, Denver, Colorado, for Appellee.

Before LEWIS, McWILLIAMS and BARRETT, Circuit Judges.

BARRETT, Circuit Judge.

G. Garvin Brown, III (Brown) appeals from a final order of the District Court affirming the decision of a referee in bankruptcy discharging the debts of Mark Paul Felsen, Bankrupt (Felsen).

The debt owed Brown by Felsen was evidenced by a judgment rendered in a state court proceeding. In January, 1974, Brown executed a guaranty in favor of the Jefferson Bank and Trust (Bank), guaranteeing payment of all indebtedness of Felsen and his company, Le Mans Motors, to a limit of $350,000. Felsen and Le Mans Motors subsequently defaulted on obligations to Bank and Bank instituted an action in state court against Felsen and Le Mans, as debtors, and Brown, as guarantor.

In answer to Bank's complaint, Brown alleged that he had executed the guaranty because he had been "induced to sign such guaranty by misrepresentation and non-disclosures of material facts by defendants hereto." [R., Vol. I, at 26.] Subsequently, Brown filed an amended answer and a cross-claim wherein he incorporated, by reference, the matters alleged in his original answer and, by cross-claim, prayed for reimbursement of any sums he might be liable for on the guaranty. The state action was not tried inasmuch as the Bank, Felsen and Brown entered into a settlement agreement, which was incorporated into a judgment. The parties' stipulation (agreement) provided for judgment in favor of Bank and against Felsen, Brown and Le Mans Motors, jointly and severally, in the amount due and owing Bank and judgment in favor Brown against Felsen and Le Mans for the same amount. No evidentiary record was made of the state court proceedings because the basis of the judgment was the parties' agreement.

In January, 1976, Felsen filed a petition for voluntary bankruptcy. Brown sought to have the judgment rendered in his favor against Felsen in the state court declared non-dischargeable, on the ground that he had become Felsen's guarantor only by reason of Felsen's fraudulent inducement and misrepresentations. Brown contended that application of Section 17(a) (2) of the Bankruptcy Act, 11 U.S.C. 35, prevented discharge. Felsen asserted, in response, that since there had been no finding of fraud in th state court proceed-

ings, the judgment was *res judicata*. A stipulated record of the state court proceedings, including the pleadings and judgment, was filed in the bankruptcy proceedings.

The referee allowed the discharge, holding that there had been no showing of fraud in the aforesaid state court proceeding:

> As the judges of this Court have unanimously interpreted those guidelines since pronounced, when a debt has been reduced to judgment in a state court, and the record of that state court proceeding is presented to a Bankruptcy Court, the Bankruptcy Court is bound to apply the results of the state court judgment to a complaint to determine the dischargeability of the debt founded upon the state court judgment. Not only is the Bankruptcy Court bound by the state court judgment when the state court record is complete, the Bankruptcy Court is also specifically interdicted by *Raley* from considering any evidence outside that record. Thus, this case must turn on that record stipulated by the parties.
>
> [R., Vol. I, at 46.]

The referee in bankruptcy rendered his decision on the basis of the stipulated record which revealed no fraudulent activity on the part of Felsen. On appeal to the District Court, the dischargeability of the judgment was affirmed.

On appeal, Brown contends that the referee and the District Court erred in allowing discharge of the judgment debt simply because the judgment and the record from which it arose do not indicate facially that the judgment was based on fraud.

Judgments rendered against a bankrupt are not classified or distinguished from other provable debts and they will be discharged unless they fall within the special exceptions delineated in Section 17(a) of the Bankruptcy Act.

8 Remington on Bankruptcy 3302, at 1522. Section 17 does prevent a bankrupt's debt from being discharged if the debt was obtained as a result of false pretenses or false representations.

I.

Brown argues that the state court record contains allegations and evidence of fraud sufficient to raise the issue of fraud relating to the debt evidenced by the judgment. He urges that this court require that the referee undertake a *de novo* hearing on this issue. We decline to do so.

In light of the parties' stipulation, it was not necessary for the state court to inquire whether the guaranty had been fraudulently induced. There is no record in existence regarding the alleged fraud. The sole basis on which Brown can now rely in his assertion that fraud motivated him to execute the guaranty is the self-serving matter contained in his answer to the Bank's complaint. This, and this alone, constitutes the sole reference to any possible fraud in the dealings between Brown and Felsen. There was no mention of any fraudulent inducement problem in the stipulation entered into between the parties. The stipulation was, of course, embodied in the judgment entered in the state court.

Brown is bound by the state court judgment in that a consent decree has the same force and effect as any other judgment and is considered to be a final adjudication on the merits. Securities and Exchange Commission v. Thermodynamics, Inc., 319 F. Supp. 1380 (D. Colo. 1970), aff'd 464 F. 2d 457 (10th Cir. 1972), *cert. denied,* 410 U.S. 927 (1973). Once it is shown that the parties did, in fact, consent to rendition of a judgment, such a judgment is deemed to be valid and binding. Hot Springs Coal Co. v. Miller, 107 F.2d 677 (10th Cir. 1939). In the instant case there is nothing in the stipulation indicating that the Brown-Felsen guaranty was induced by fraudulent representations. Parties

involved in a consent judgment waive their rights to litigate the issues involved in the case as posed by the pleadings. United States v. Armour and Co., 402 U.S. 673 (1971). Thus, we hold that Brown cannot now raise the issue of fraud. Furthermore, Brown's allegation of fraudulent misrepresentations contained in his answer in the state court proceeding does not adequately raise the issue of fraud for bankruptcy consideration. In addition, his casual answer does not meet the requirements of Rule 9, Colorado Rules of Civil Procedure, that all averments of fraud and the circumstances constituting fraud must be stated with particullarity.

There is nothing in this record which indicates that the stipulation reached in settling the litigation in the state court proceeding between Bank, Brown and Felsen was in any manner induced by fraud. Thus, we must reject Brown's contention that the pleadings raise an issue of fraud. In like manner, we hold that Brown is not entitled to a *de novo* hearing on the alleged fraud issue.

II.

Brown contends that even if fraud was not adequately raised in the state court proceedings, the question of dischargeability is within the sole province of the Bankruptcy Court and that, accordingly, the state court judgment cannot be held to be *res judicata* on this issue.

The determination as to whether a debt is the result of a fraudulent transaction is, of course, within the ambit of the Bankruptcy Act. However, in the instance where a debt has been reduced to judgment, a referee in bankruptcy generally will not go beyond the record of the proceedings in which the judgment was rendered in order to ascertain if discharge will lie:

> Where, however, a liability has been prosecuted to judgment, the record is usually held decisive as to the

> character of the claim upon which the judgment is founded, and cannot be affected by the introduction of parol evidence except in the case of ambiguity. In order that a judgment based upon a fraudulent representation may be excepted from the operation of a discharge, the record in the action must show that fraud and deceit were the 'gist and gravamen' of the action.
>
> Collier on Bankruptcy, Vol. IA, s 17.16 (4), at 1643-6.

This court has rendered two opinions dealing with the discharge of a judgment creditor in a bankruptcy proceeding. They hold that the record of the proceeding in which a judgment was rendered prior to bankruptcy proceedings will generally control in a subsequent bankruptcy proceeding.

In In re Nicholas 510 F.2d 160 (10th Cir. 1975), *cert. denied*, 421 U.S. 1012 (1975), a creditor sued to prevent discharge of a default judgment awarded him in a state court proceeding. The creditor claimed that discharge should not lie, inasmuch as the original liability upon which the judgment was based had been obtained through fraud and false pretenses. In support of his contention the creditor filed an affidavit which contained alleged information that the debtor had, in essence, "cheated" the creditor. This court held that where an examination of the entire record and the judgment does not evidence that the liability was predicated on fraud, the referee in bankruptcy must refuse to permit the judgment creditor to introduce extrinsic evidence to the effect that the liability was, in reality, based on fraud. We there observed:

> The record of the proceedings in the state court clearly indicated that the liability was one for damages arising out of breach of contract and not fraud. Under such circumstances, there was no need to resort to extrinsic evidence.
>
> 510 F.2d, at 164.

We again articulated the rule that a state court record and judgment will control in a subsequent bankruptcy action in In re Vickers, an unpublished opinion (No. 76-2175, decided August 19, 1977). We there observed:

> The rule in this circuit is that when a debt sought to be discharged has been reduced to judgment in state court, the nature of the obligation is to be determined on the basis of the record and the judgment in that action. Absent ambiguity as to the nature of the claim, no resort may be had to extrinsic evidence.
>
> Ibid, at 6.

WE AFFIRM.

Supreme Court, U. S.
FILED
OCT 2 1978

In the

Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III, Petitioner

v.

MARK PAUL FELSEN, Respondent.

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

ALEX STEPHEN KELLER
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Denver, Colorado 80202

COUNSEL FOR RESPONDENT

September 28, 1978

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In the

Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III, Petitioner
v.
MARK PAUL FELSEN, Respondent.

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The respondent Mark Paul Felsen respectfully prays that the Petition for a writ of certiorari filed by the petitioner herein be denied. As grounds therefor, respondent states as follows:

With reference to the Petition, the statements regarding the Opinion Below, jurisdiction questions presented, statutory provisions involved, and the accuracy of the appendices attached to the Petition, are conceded.

STATEMENT OF THE CASE

The petitioner's Statement of the Case is generally accurate, but we wish to point out certain specific additional items:

The bank commenced an action on June 19, 1975 against LeMans Motors, Inc., a Colorado corporation, Mark Felsen, and G. Garvin Brown, III, in the District Court

for the County of Jefferson, State of Colorado. The corporation and Felsen answered and Brown answered. In paragraph 3 of the affirmative defenses in Brown's answer appears the statement quoted on page 5 of the Petition. Brown filed an amended answer in which he incorporated his previous answer, including the above quoted language from paragraph 3 of the affirmative defenses of his original answer.

Brown also filed a cross-claim against the corporation and Felsen, quoted as follows:

"FIRST CROSS-CLAIM

"1. Any liability which this Defendant purportedly has to Plaintiff arises out of a guaranty executed by this Defendant on behalf of LeMans Motors, Inc. and Mark Felsen.

"2. If judgment is had against this Defendant by Plaintiff, then this Defendant is entitled to be indemnified by LeMans Motors, Inc. and Mark Felsen for the full amount of said judgment, plus this Defendant's costs and expenses."

Following discovery, motions for summary judgment, pre-trial statements and a trial setting, a stipulation was executed by the parties, through counsel, that judgment would enter on plaintiff's complaint (founded entirely on the promissory note and a guaranty), and judgment would enter in favor of Brown on his cross-claim (quoted above) against the corporation and Felsen. That stipulation was reduced to judgment and no evidentiary hearing was had before the Trial Court. Judgment entered in December, 1975.

The Petition asserts on page 5 that the issue of fraud, while concededly not pleaded in Brown's cross-claim, was raised on the face of the answer. The Petition further asserts on page 5 that the State Court record contains clear and unequivocal allegations of fraud.

Respondent differs with this characterization because Rule 9(b) of the Colorado Rules of Civil Procedure provides as follows:

> "(b) *Fraud, Mistake, Condition of the Mind.* In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

Colorado's leading case on fraud is *Morrison v. Goodspeed,* 100 Colo. 470, 68 P. 2d 458. This case specifically sets forth the requirements for the pleading and proof of fraud. Considering the rule and the above cited case, the State Court record does not rise to any sort of pleading of fraud. It doesn't even state the defendant against whom the allegation is directed. In the Opinion Below the Court refers to this question (Petition, App. 9) as a "casual answer."

The Petition then alleges that the deposition of the respondent is "riddled with admissions of fraud." Respondent disagrees.

On page 7 of the Petition it is stated that the Bankruptcy Court granted the motion for summary judgment on the grounds of *res judicata.* The opinion of the Bankruptcy Court does not specifically so state but simply relies on a controlling case from the United States Court of Appeals for the Tenth Circuit.

REASONS FOR NOT GRANTING THE WRIT

We now wish to discuss, in the same order as the Petition, petitioner's reasons for granting the writ:

A. Counsel relies on *In re Pigge,* 539 F. 2d 369 (1976). This case was decided June 11, 1976 (after the case upon which the Bankruptcy Court relied from the Tenth Circuit).

The Bankruptcy Court and the District Court in the case at Bar relied on *In re Nicholas,* 510 F. 2d 160 (10th Cir.), *cert. denied,* 421 U.S. 1012 (1975).

In Pigge (supra), from the Fourth Circuit, there was a state court judgment on contract, and the Bankruptcy Court and the District Court agreed with the bankrupt that the creditor had no right to offer extrinsic evidence to prove non-dischargeability. Pigge appears to be contrary to Nicholas (supra), but it is interesting to note that it doesn't cite it.

On page 10 of the Petition, petitioner complains that the Tenth Circuit made no attempt to reconcile its interpretation with Pigge, (supra). How could it, when Pigge was decided later?

On page 11 counsel then cites a 1964 case from the Ninth Circuit which is of little value because the case was decided prior to the 1970 amendments to the statute. Petitioner cites *In re Houtman,* 568 F. 2d 651 (1978), from the Ninth Circuit, but Houtman is totally different in the facts because in that case in a jury trial before the state court, the creditor's claim for fraud was sustained. The Bankruptcy Court held the debt dischargeable. The lower court was affirmed and the Ninth Circuit held that a state court judgment, based on fraud, is sufficient to establish a prima facie case that the debt is non-dischargeable but that the bankrupt is entitled to rebut this prima facie case.

The Petition then cites Third and Second Circuit cases prior to 1970, which respondent does not believe are applicable since they were decided before the 1970 amendments.

Petitioner asserts that the Tenth Circuit's determination "squarely collides" with other circuits, but this is not correct when taken in proper context and considering the dates of the decisions. It conflicts only with the Fourth Circuit. Notably in the Tenth Circuit case, a petition for writ of certiorari was denied.

B. Petitioner filed a supplemental memorandum referring to *In re McMillan,* (1978) 2 Bankr. L. Rep. (CCH)

§66,883 (3rd Cir., filed June 21, 1978). Respondent believes this case supports his position. In that case the creditor filed a complaint based on fraud in the State Court and obtained a judgment by default. The Bankruptcy Court, asked to rely on the State Court judgment, ruled the debt dischargeable. The District Court affirmed. The Third Circuit affirmed. In the opinion it is stated that the creditor did not adequately plead fraud. The Court further stated that as between parties and their privies an issue need and should be judicially determined only once. The Court relied heavily on the fact that in a default judgment the issue was not actually litigated and thus the doctrine of *res judicata* or collateral estoppel does not come into full play. The Court undoubtedly had in mind the fact that judgments by default are subject to different rules than other judgments. They are liberally opened, corrected or vacted, and descretion is usually exercised in favor of granting such applications. These rules are fundamental and are generally discussed at 46 Am. Jur. 2d 837, Judgments, §686.

In the case at Bar, after the case had already been set for trial, a judgment by consent was entered. The matter was in fact litigated for many months although no trial was held. A judgment by consent is in an entirely different category than a judgment by default and has the same effect as a judgment after a trial on the merits. This fundamental rule is discussed generally in 46 Am. Jur. 2d 840, Judgments, §688.

C. Beginning on page 12, the Petition discusses significant practical problems. In order to discuss this in its proper context, the logic of In re Nicholas (supra) should be examined. In that case the creditor had obtained a judgment by default in a state court in New Mexico. The state judgment was based entirely on contract. The Bankruptcy Court granted summary judgment to the bankrupt holding that the State Court judgment, being based only on contract,

cannot be reexamined. It held that in view of the complete record made before the State Court, there was no need to resort to extrinsic evidence to ascertain the nature of the underlying debt.

The Trial Court indicated that if there were any ambiguity or doubt as to the State Court proceeding, resort could be had to extrinsic evidence. Purely and simply, the Tenth Circuit stated unequivocally that when a creditor relies totally on a contractual theory in the State Court and then finds that his judgment may not be collectible because the debtor filed a petition in bankruptcy, he cannot be permitted as an afterthought to change his claim to fraud. This conclusion is absolutely logical and results in the reduction of litigation in the Federal Court system.

Congress provided people in great financial difficulty a remedy under which they can get a fresh start. Ordinarily, the bankrupt's position is favored. Why should there be an exception in cases where the state courts have already acted and where a creditor did not even raise fraud in the state court? Why should a creditor be allowed to continue to harass a debtor and make him incur additional attorney's fees and costs to again defend himself in the Bankruptcy Court on a claim already adjudicated in the state court?

In the case of In re Nicholas, the Bankruptcy Court did not only examine the judgment but the entire record, as in the case at Bar. The Tenth Circuit did not hold that resort can never be had to extrinsic evidence. It merely held that when a state court record is crystal clear in its entirety, a creditor should not be allowed to have a second bite.

The Petition complains bitterly that creditors holding commercial paper must alter their ways to pursue collection and must pursue their fraud remedies in the state court. Not at all. First of all, the bankruptcy statute is not

designed to aid commercial creditors but is designed to aid the bankrupt. Secondly, if the commercial creditor in truth has a valid claim for fraud in the state court, he should litigate it. If it is properly pleaded and determined in the creditor's favor, he will have a great advantage in the Bankruptcy Court although, as previously stated, the bankrupt may rebut the prima facie record.

Why in the world would a commercial creditor file simply a complaint or cross-claim on contract or indemnity, when in fact his claim is one for fraud? Perhaps commercial creditors do not wish to go to the expense of proving fraud, but if in fact it clearly exists why should the burden of doing so be removed?

On page 15 of the Petition reference is made to a "wily defendant." This reference is entirely speculative and there is not one shred of evidence in the case at Bar that the respondent intended or contemplated the filing of a petition in bankruptcy during the state court litigation. Throughout the state proceedings petitioner was represented by highly competent counsel and was perfectly at liberty to follow the Colorado law by properly pleading fraud and proving it.

The benefit to a commercial creditor to obtain a judgment based on fraud in the state court not only relates to a possible future bankruptcy but can have other results, such as punitive damages and body execution.

Counsel cites *Schwartz v. Blue,* ..... Colo. App. , 573 P. 2d 941 (1977). This case simply holds that the final jurisdiction to determine dischargeability lies in the Bankruptcy Court. This case can be of no comfort to petitioner.

On page 18 of the Petition, petitioner states that a creditor is denied the opportunity to have the true nature of the obligation determined. For the reasons above stated, this is totally incorrect. The Petition also claims that the practice of limiting a suit on commercial paper to breach of contract, even though a fraud claim may be available, is

widespread. Respondent disagrees. On the contrary, if a creditor has a bona fide clear claim for fraud, it is almost always presented to the state court because of the basic principle that not only matters which are actually pleaded, but also those which could have been pleaded, are subject to the rule of *res judicata*.

D. The failure of the Bankruptcy Court to examine respondent's deposition has in general already been dealt with. First of all, respondent contends that even if they had, it would be of no comfort. Secondly, in the case at Bar there was a stipulation before the Bankruptcy Court as to the record in the State Court, and this stipulation is binding on the petitioner (Pet. App. 5).

CONCLUSION

For the reasons above stated, the Petition for writ of certiorari should be denied.

Respectfully submitted,

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September 28, 1978

Supreme Court, U. S.
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DEC 13 1978
MICHAEL RODAK, JR., CLERK

In the

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-58

G. GARVIN BROWN, III,

Petitioner,

v.

MARK PAUL FELSEN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Court of Appeals (A. 50) and Findings, Conclusions and Order of the Bankruptcy Court for the District of Colorado (A. 44), are not reported. No opinion was rendered by the District Court for the District of Colorado, but an Order was entered by the District Court (A. 49) affirming the Order of the Bankruptcy Court.

JURISDICTION

The judgment of the Court of Appeals (A. 57) was entered on April 14, 1978. The petition for a writ of certiorari was filed on July 10, 1978 and was granted on October 30, 1978. The jurisdiction of this Court rests upon 28 U.S.C. § 1254(1).

STATUTES INVOLVED

84 Stat. 990 (1970)
§ 17 of the Bankruptcy Act, as amended,
11 U.S.C. § 35 – Debts Not Affected by Discharge.

The verbatim text of 11 U.S.C. § 35 is set forth in the appendix to this brief.

QUESTIONS PRESENTED

1. Whether a pre-bankruptcy state court judgment is *res judicata* on the issue of the dischargeability of the debt in bankruptcy.

2. Whether Section 17c(2) of the Bankruptcy Act confers exclusive jurisdiction on the Bankruptcy Court to determine the dischargeability of debts under Sections 17a(2) and (4) and allows the Bankruptcy Court to look behind the state court judgment.

3. Whether the Bankruptcy Court may admit and consider evidence extrinsic to the state court record in determining the dischargeability of the debt.

STATEMENT OF THE CASE

This is a suit filed in the Bankruptcy Court seeking a determination that a certain debt evidenced by a pre-bankruptcy state court judgment was not dischargeable on the basis of Section 17 of the Bankruptcy Act, as amended, 84 Stat. 990 (1970) (also referred to as 11 U.S.C. § 35). The Bankruptcy Court entered judgment for the Respondent Felsen and determined that the debt was dischargeable. The District Court for the District of Colorado and the Court of Appeals for the Tenth Circuit affirmed that determination.

In June, 1975, the Jefferson Bank & Trust ("the Bank") commenced an action against Respondent Mark Paul Felsen ("Felsen"), his company Le Mans Motors, Inc.,

and Petitioner G. Garvin Brown, III ("Brown") in the District Court in and for the County of Jefferson, State of Colorado ("the State Court Action") (A. 12).

The Bank's claims against Felsen were based on the non-payment of certain debts owed by Felsen to the Bank. (A. 12-15). The Bank's claim against Brown was based on a guaranty executed by Brown in favor of the Bank, guaranteeing payment of Felsen's indebtedness to the Bank (A. 15). Brown filed an answer to the Bank's complaint (A. 34) containing affirmative defenses to the Bank's claim and stating in pertinent part:

> 3. This Defendant [Brown] was induced to sign such guaranty by misrepresentations and nondisclosures of material facts by the other defendants [Felsen and Le Mans Motors] . . . . (A. 35).

Thereafter, Brown filed an Amended Answer with a crossclaim, which specifically incorporated by reference the Answer (A. 38). The crossclaim against Felsen was a claim for indemnity based on the guaranty.

The deposition of Felsen was taken in the State Court proceedings on October 13, 1975 (Deposition Vols. IA and IB).[1] Shortly after this deposition occurred, Felsen entered into a stipulation for the full amount claimed against him by Brown on the crossclaim in the State Court Action (A. 40) and the State Court entered judgment based on the stipulation ("the Judgment") (A.42). The State Court Judgment was based exclusively on the Stipulation. It made no determination of any issue of fact or law pertaining to the suit, nor did it specifically rule on the nature of the obligation or its dischargeability. No evidentiary record was made in the State Court.

---

[1] Reference is to the Deposition of Mark Paul Felsen taken on October 13, 1975 in the State Court action which is a part of the record herein.

On January 6, 1976, Felsen filed his petition in bankruptcy (A. 1). Thereafter, Brown commenced an action in Bankruptcy Court (A. 3) pursuant to Part VII of the Bankruptcy Rules, seeking a determination that the debt owed by Felsen to Brown evidenced by the Judgment, was not dischargeable on the grounds that the debt was for money or property obtained by false pretenses within the meaning of 11 U.S.C. § 35(a)(2), and for fraud, embezzlement, misappropriation or defalcation while acting as an officer or a fiduciary within the meaning of 11 U.S.C. § (35(a) (4). Felsen anwered (A.7) and moved for summary judgment on the ground that the Judgment was *res judicata* on the issue of dischargeability, because it contained no finding of fraud on its face (A.9)

Felsen's motion for summary judgment was granted. (A. 44). The Findings, Conclusions and Order of the Bankruptcy Court makes note of the fact that fraud was raised as an issue in the State Court case and that no factual determination was made by the State Court (A. 47). The Bankruptcy Court granted the motion for summary judgment holding that, because the Judgment did not state on its face, and examination of the State Court record did not indicate conclusively, that it was based upon fraud, the debt was dischargeable. (A. 48).

The District Court affirmed the determination of the Bankruptcy Court (A. 49) as did the United States Court of Appeals for the Tenth Circuit (A. 50).

The Tenth Circuit, based on its own earlier opinion, concluded that the State Court record and Judgment are controlling in a subsequent bankruptcy proceeding and that the Bankruptcy Court must refuse the introduction of extrinsic evidence on the issue of fraud in determining dischargeability (A. 55).

SUMMARY OF ARGUMENT

The language and purpose of 11 U.S.C. § 35, as amended, make it clear that it was Congress' intent to vest exclusive jurisdiction to determine the issue of dischargeability in the Bankruptcy Courts with respect to claims for fraud, and willful and malicious conversion of property. This extended what had already been the practice under certain circumstances, to all determinations of this sort. The legislation is based on certain practical and policy considerations. Certain abuses had sprung up whereby creditors could effectively circumvent a discharge and keep certain debts alive. In addition, the Bankruptcy Act is a federal statute which in the final analysis is interpreted by the federal courts, not the state courts, and which should carry a uniform interpretation.

The Tenth Circuit interpretation merely substitutes one abuse for another, clearly not what Congress could have intended. It forces creditors to raise superfluous issues in state court proceedings because of the possibility of a bankruptcy in the future. This ties up the courts' time with issues which may never become relevant, or only at a later time in a later proceeding.

Because the Bankruptcy Court cannot go behind the State Court record under the Tenth Circuit rule, it leaves the adjudication of dischargeability essentially with the states, not the Bankruptcy Court as Congress intended. However, some state courts have made clear that they will not determine that issue, leaving the creditor with no court in which he can be heard on the issue of dischargeability. Even if a debtor is successful in having the fraud claim and its dischargeability determined in a state court, if these issues are collateral in rendering the judgment, they still may not be binding on the debtor and the matter can be relitigated, causing two hearings on these issues, where only one is necessary.

Both the law and sound judicial administration require that a Bankruptcy Court be the arbiter of dischargeability and conduct its own hearing in order to do so.

ARGUMENT

THE BANKRUPTCY COURT HAS EXCLUSIVE JURISDICTION TO DETERMINE DISCHARGEABILITY OF CERTAIN DEBTS, AND SHOULD CONSIDER EVIDENCE EXTRINSIC TO THE STATE COURT RECORD IN MAKING ITS DETERMINATION.

A. The Bankruptcy Act Vests the Bankruptcy Court with the Exclusive Jurisdiction to Determine the Issue of Dischargeability with Respect to Claims for Fraud and Willful and Malicious Conversion of Property.

The exclusive jurisdiction of the Bankruptcy Court over the issue of dischargeability was made clear in 1970 when Congress amended Section 17 of the Bankruptcy Act to provide a procedure in the Bankruptcy Court by which a bankrupt or a creditor can have the dischargeability of a debt determined.[2] It specifically states in Subsection (c)(3) that the Bankruptcy Court "shall determine the dischargeability of any debt for which an application for such determination has been filed . . .", and in Subsection (c)(2) that with regard to debts not dischargeable under Subsections (a) (2), (4) or (8), if a creditor seeks a determination of nondischargeability he *must* file his application in the Bankruptcy Court. The language is mandatory and effectuates the expressed purpose of the statute to make the Bankruptcy Courts the exclusive arbiters of the issue of dischargeability.

Both the House and Senate advised[3] that the new law makes clear beyond peradventure that the Bankruptcy

[2] The Bankruptcy Reform Act, P.L. 95-598 (1978), contains essentially the same provision in Section 523.

[3] S. Rep. No. 91-1173, 91st Cong., 2d Sess. (1970); H.R. Rep. No. 91-1502, 91st Cong., 2d Sess. (1970).

Courts will have exclusive jurisdiction to determine dischargeability with respect to claims for fraud and willful and malicious conversion of property:

> Under it, the matter of dischargeability of the types of debts commonly giving rise to the problem; that it, those allegedly incurred as a result of loans based upon false financial statements, will be within the exclusive jurisdiction of the bankruptcy court. S. Rep. No. 91-1173 at 2; H.R. Rep. No. 91-1502 at 2.

The statutory change was prompted by the practical problems which had arisen in the administration of the Bankruptcy Act with regard to the discharge of debts.

One of the problems was the potential and actual abuse of the current procedure by creditors. Prior to the 1970 Amendments, the determination of the dischargeability of a debt was a two-pronged process. The Bankruptcy Court determined whether a discharge should be granted, and another court, either state or federal district court, determined the effect of the discharge on the particular claim or debt. After a bankrupt received his discharge, a creditor would sue in state court alleging fraud or similar claims. The debtor, relying on the discharge in bankruptcy, might ignore the State Court proceeding. However, because discharge of the debt in bankruptcy was an affirmative defense, failure to respond to the state court action and plead the discharge would lead to judgment for the creditor. Thus, the creditor would obtain a default judgment on the basis of fraud, a non-dischargeable obligation.[4]

Even prior to the 1970 Amendment, the Bankruptcy Court could under unusual circumstances hear the case and

[4] Memorandum of the National Bankruptcy Conference of January 21, 1970, to the Senate Judiciary Committee, reproduced in S. Rep. No. 91-1173 at 7, and in the record of House deliberations, 116 Cong. Rec. H. 9550 (Oct. 5, 1970); Countryman, *The New Dischargebility Law*, 45 Bank, L.J. 1 (1970).

review the dischargeability of a specific debt. In doing so, it could even hear evidence extrinsic to the existing record. *Local Loan Co. v. Hunt,* 292 U.S. 234 (1934); *Martin v. Rosenbaum,* 329 F. 2d 817 (9th Cir. 1964); *In re Johnson,* 323 F. 2d 574 (3d Cir. 1963); *Greenfield v. Tuccillo,* 129 F. 2d 854 (2d Cir. 1942). This exception was apparently invoked when the courts determined that the debtor was being abused and fairness dictated a review of the state judgment.

The abuse was cured by vesting in the Bankruptcy Court the power to determine the dischargeability of the debt, and to provide the debtor with a meaningful opportunity to be heard on the issue. As the National Bankruptcy Conference advised, the investiture of exclusive jurisdiction in the Bankruptcy Court merely extended, and made routinely available to debtors and creditors, review of the issue of dischargeability. The judicial remedy was adopted as a statutory one.

A second factor behind the legislation is the federal nature of the Bankruptcy Act. The Bankruptcy Act is a federal statute which should carry a uniform interpretation throughout the country. In ruling on issues, such as dischargeability, the Bankruptcy Court is applying federal law and is not bound by the state law. Lee, *Case Comment,* 50 Am. Bankr. L. J. 175 (1976).

> [I]n the last analysis, it is the U.S. Supreme Court which has ultimate word on the construction of Section 17 of the Bankruptcy Act . . . . Since this is a Federal Statute, the Federal courts necessarily have the final word as to the meaning of any terms contained therein.[5]

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[5] Letter of Royal E. Jackson, Chief, Division of Bankruptcy of September 15, 1970, to the Chairman, Senate Committee on the Judiciary, reproduced in S. Rep. 91-1173, at 6.

Thus, whether or not a particular debt is dischargeable because of fraud, false pretense or malicious and willful acts of the bankrupt is a matter of federal law, specifically turned over to the Bankruptcy Courts for interpretation.

B. The Purpose of the Bankruptcy Act and Sound Judicial Administration Dictate that the Bankruptcy Courts Hear Evidence Dehors the State Court Record in Determining Dischargeability.

The purpose and goals of 11U.S.C. § 35 can only be accomplished if the Bankruptcy Court can hear and consider evidence concerning the nature of debt, which may be *dehors* the state court record. *In re McMillan,* 579 F. 2d 289 (3d Cir. 1978); *In re Houtman,* 568 F. 2d 651 (9th Cir. 1978); *In re Pigge,* 539 F. 2d 369 (4th Cir. 1976); *See also, Fierman v. Lazarus,* 361 F. Supp. 477 (E. D. Pa. 1973), *aff'd,* 493 F.2d 1400 (3d Cir. 1974); *In re Burns,* 357 F. Supp. 176 (D. Kan. 1972).

The interpretation of the Tenth Circuit in this case and in *In re Nicholas,* 510 F. 2d 160 (10th Cir.), *cert. denied,* 421 U.S. 1012 (1975) appears to ignore the express language and purpose of the Amendments in 1970, allowing the state courts to determine whether the debt is dischargeable. This is contrary to the law as expressed in 11 U.S.C. § 35.

The Tenth Circuit's opinion in this case reflects a policy determination that has broad ramificiations for all holders of commercial paper, such as notes or guaranties, pursuing their claims against potential bankrupts. The interpretation of 11 U.S.C. § 35 adopted by the Tenth Circuit forces a creditor, while pursuing his claim in state court, to anticipate the debtor's bankruptcy and to make certain that every judgment arising from a state court proceeding rests squarely on fraud, rather than on breach of contract. In order to protect himself, the creditor must commit the very abuse Congress intended to cure, namely seek a default or

litigated judgment making certain that its based primarily on the ground of fraud.

This reduces the incentive of a commercial creditor to settle a case and stipulate judgment because that judgment may omit the crucial rulings on fraud. It forces the creditor to proceed on, and forces the court to try, issues of fraud because of the possibility of a future bankruptcy. Thus, even though a claim for breach of contract is uncontested, the parties must proceed on a superfluous claim of fraud in order to protect against a discharge. The result is to place an additional burden on the courts' already overcrowded dockets. Even though only a small fraction of claims will end up in bankruptcy, in order to protect himself, a creditor must in each case raise all issues of fraud and dischargeability.

The issue was addressed by the Third Circuit in *In re McMillan, supra.* That Court recognized the practical administrative problem inherent in such a situation:

> The defendant in a suit should not be compelled, at his peril, to embark on extensive litigation involving perhaps some minor matters in order to prevent the operation of a judgment which would be held conclusively to have established against him every material fact alleged and not denied in the declaration, so as to preclude him from showing the truth if another controversy should arise between the same parties. 579 F. 2d at 293.

Under the Tenth Circuit interpretation, the question of dischargeability in actuality will be determined by the state. The nature of the indebtedness is the critical determination for purposes of dischargeability and the Tenth Circuit rule transfers that determination to the State court, leaving to the bankruptcy court merely the formal application of 11 U.S.C. §35. Consequently, the Tenth Circuit

treats the failure of the state court to enter judgment on nondischargeable grounds as a bar to the creditor pursuing nondischargeability in bankruptcy court, even though the particular facts pertaining to 11 U.S.C. §§ 35 (a)(2) or (4) may not be raised in the state court because they would not be necessary to obtaining judgment on commercial instruments. Such facts become relevant only after a bankruptcy is pending and only on the issue of dischargeability. Such facts have no bearing on whether or not one party is indebted to another and the state court is not directly focusing on the issue of dischargeability. The 1970 Amendment to Section 17 was designed to cure certain abuses by creditors. The Tenth Circuit approach merely creates an opportunity for abuse by the debtors, and provides a judicially sanctioned means of circumventing the statute. A wily debtor need only default or agree to a judgment in state court on any ground but fraud, then rush into bankruptcy.

An additional consideration was focused on in *McMillan.* Essential to the applicability of the doctrine of *res judicata* is that the issue have been actually litigated. A default judgment, or stipulated judgment, involves no determination by the finder of fact and provides no real guidance on the merits of the case to courts which may later have cause to consider the judgment. Similarly, if a contract and a fraud claim are pleaded, it is generally unnecessary for the court to even consider the fraud claim in rendering judgment. *In re Pigge, supra.* Thus, even if a creditor frames his case in anticipation of bankruptcy, it is not clear that he can avoid duplicate hearings in many cases, adding to the burden of the courts. If two claims, contract and fraud, are raised, and judgment entered on both, the creditor may still not be able to rely on the judgment. If an issue, such as the fraud issue, is not necessary to the rendition of the judgment, but was merely collateral, a prior judgment will not foreclose consideration of the same issue again. *Halpern v. Schwartz,* 426 F. 2d 102, 105 (2d Cir. 1970).

The facts and issues peculiar to 11 U.S.C. § 35 should not be raised in a state court proceeding because dischargeability is not at that time in issue. The doctrine of *res judicata* is therefore not applicable. Even if a creditor attempted to present the issue to the state court, the state courts, at least in the Tenth Circuit, are unwilling to take up these additional claims. Schwartz v. Blue, ... Colo. App. ..., 573 P. 2d 941 (1977); *Kuzemchak v. Pitchford,* 81 N.M. 438, 468 P 2d 409, *cert. denied,* 400 U.S. 833 (1970).

The state court will not determine whether a particular debt is nondischargeable because of fraud, false pretenses or malicious and willful acts of the bankrupt and the Tenth Circuit has stated that Bankruptcy Courts cannot make such a determination independent from the state court record. A creditor is effectively denied an opportunity to have the true nature of the obligation determined. One abuse has been substituted for another.

Both the law and sound judicial administration require that the Bankruptcy Court be the arbiter of dischargeability of a debt evidenced by a pre-bankruptcy judgment and conduct its own hearing in order to do so. Failure to allow a Bankruptcy Court to admit and consider evidence effectively makes the state courts the final adjudicators of this issue, contrary to 11 U.S.C. §35 and its expressed purpose.

CONCLUSION

The judgment of the Court of Appeals affirming the order granting summary judgment should be reversed, and Petitioner should be allowed to proceed on his Complaint to Determine Dischargeability in the Bankruptcy Court.

Respectfully submiited,

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APPENDIX

35. *Dischargeability of debts—Debts not affected by a discharge.* (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: Provided, however, That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fradulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this title: *And provided further,* That a discharge in bankruptcy shall not release or affect any tax lien; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the

property of another; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; (5) are for wages and commissions to the extent they are entitled to priority under subdivision (a) of section 104 of this title; (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment; (7) are for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; or (8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subsdivision.

(b) The failure of a bankrupt or debtor to obtain a discharge in a prior proceeding under this title for any of the following reasons shall not bar the release by discharge in a subsequent proceeding under the title of debts that were dischargeable under subdivision (a) of this section in the prior proceeding: (1) discharge was denied in the prior proceeding solely under clause (5) or clause (8) of subdivision (c) of section 32 of this title; (2) the prior proceeding was dismissed without prejudice for failure to pay filing fees or to secure costs. If a bankrupt or debtor fails to obtain a discharge in a proceeding under this title by reason of a waiver filed pursuant to section 32(a) of this title or by reason of a denial on any ground under section 32(c) of this title other than clause (5) or clause (8) thereof, the debts provable in such proceeding shall not be released by a discharge granted in any subsequent proceeding under this title. A debt not released by a discharge in a proceeding under this title by reason of clause (3) of sub-

division (a) of this section may nevertheless be dischargeable in a subsequent bankruptcy proceeding.

(c) (1) The bankrupt or any creditor may file an application with the court for the determination of the dischargeability of any debt.

(2) A creditor who contends that his debt is not discharged under clause (2), (4), or (8) of subdivision (a) of this section must file an application for a determination of dischargeability within the time fixed by the court pursuant to paragraph (1) of subdivision (b) of section 32 of this title and, unless an application is timely filed, the debt shall be discharged. Notwithstanding the preceding sentence, no application need be filed for a debt excepted by clause (8) if a right to trial by jury exists and any party to a pending action on such debt has timely demanded a trial by jury or if either the bankrupt or a creditor submits a signed statement of an intention to do so.

(3) After hearing upon notice, the court shall determine the dischargeability of any debt for which an application for such determination has been filed, shall make such orders as are necessary to protect or effectuate a determination that any debt is dischargeable and, if any debt is determined to be nondischargeable, shall determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof. A creditor who files such application does not submit himself to the jurisdiction of the court for any purposes other than those specified in this subdivision (c).

(4) The provisions of this subdivision (c) shall appply whether or not an action on a debt is then pending in another court and any party may be enjoined from instituting or continuing such action prior to or during the pendency of a proceeding to determine its dischargeability under this subdivision.

(5) Nothing in this subdivision shall be deemed to affect the right of any party, upon timely demand, to a trial by jury where such right exists.

(6) If a bankruptcy case is reopened for the purpose of obtaining the orders and judgments authorized by this subdivision no additional filing fee shall be required.

In the

Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III,

Petitioner,

v.

MARK PAUL FELSEN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The Opinions Below, as set forth in the Appendix, are accurate.

JURISDICTION

Jurisdiction is admitted.

STATUTES INVOLVED

The statutes cited by petitioner are the applicable statutes.

QUESTION PRESENTED

Whether a creditor who did not raise fraud in the State Court proceedings and raises it for the first time in the Bankruptcy Court is, in all cases, entitled to a complete trial in the Bankruptcy Court when the State Court judgment is by consent based on contract only.

STATEMENT OF THE CASE

The Statement of the Case of petitioner is accurate.

SUMMARY OF ARGUMENT

There is no dispute that the applicable statute vested exclusive jurisdiction in the Bankruptcy Court to determine dischargeability. In the case at Bar the Bankruptcy Court determined that the debt was dischargeable, relying on *In re Nicholas,* 510 F. 2d 160 (10th Cir.) *cert. denied,* 421 U.S. 1012 (1975). Petitioner in the case at Bar relies on *In re Pigge,* 539 F. 2d 369 (4th Cir. 1976). The two cases from two different circuits reach contrary conclusions.

Petitioner speculates as to the reasons for the 1970 amendments to 11 U.S.C. §35. Whether the reasons for the amendments are as petitioner states is immaterial. The issue is, what is the effect of the amendments? The obvious effect is to vest jurisdiction to determine dischargeability in the Bankruptcy Court, nothing more and nothing less. The amendments do not eliminate the doctrines of res judicata, estoppel, waiver, collateral estoppel or the rules of pleading, as petitioner contends.

Petitioner argues that creditors are forced to raise superfluous issues in the state courts, thus tying up the state court's time with issues which will never become relevant. The other side of the same argument is that, under petitioner's theory, bankruptcy courts would be tied up in trial on matters long since fully resolved in the state courts and would permit creditors, as an afterthought, to raise fraud

for the first time in the bankruptcy court in a last ditch effort to collect debts from people with no money.

There is no reason why a creditor with a bona fide fraud case would not proceed in the state court to prove it. Fraud has consequences other than non-dischargeability, such as punitive damages and body execution. Surely by the time a state court case comes to trial, the creditor knows whether the debtor has assets or not, and if the debtor has little or no assets, the creditor must contemplate the possibility of a bankruptcy petition.

Petitioner argues that as the result of the Tenth Circuit's rule, dischargeability is determined by the state courts, but this is carrying the rule in the Tenth Circuit far beyond *In re Nicholas, supra,* and reduces the rule to the ridiculous. Of course state courts have declined to rule on dischargeability in bankruptcy. They have no jurisdiction to make such determination, but are perfectly capable of determining fraud.

ARGUMENT

A CREDITOR WHO HAS NOT PLEADED FRAUD IN A STATE COURT PROCEEDING AND ENTERS INTO A STIPULATION AND CONSENTS TO A JUDGMENT BASED ON CONTRACT, IS NOT ENTITLED TO A FULL TRIAL IN THE BANKRUPTCY COURT IN ALL CASES.

In order to place this issue in its proper perspective, one must first examine *In re Nicholas, supra.* A unanimous panel of the Tenth Circuit was faced with a judgment in New Mexico for breach of contract. Fraud had not been pleaded. The debtor filed a petition in bankruptcy, scheduled the judgment, and the creditor filed a complaint in the Bankruptcy Court seeking to prevent discharge of the State Court judgment. The bankrupt filed a motion for summary judgment attaching a certified copy of the State Court pro-

ceedings. The trial court held that there was no need to resort to extrinsic evidence to ascertain the true nature of the underlying debt but stated that if there were ambiguity or doubt as to the state court proceeding, resort could be had to extrinsic matters.

Mindful of the 1970 amendments, the Tenth Circuit held that the substantive law had not been changed by the amendments. When the entire state court record, not just the judgment, is before the court and based on contract, extrinsic evidence is unnecessary.

The case clearly holds that the jurisdiction to determine dischargeability rests with the bankruptcy court, but delineates what the bankruptcy court can or cannot consider in making its determination. Nothing in the 1970 amendments indicates that the rules of evidence and other procedural rules are intended to be changed; neither are the rules of res judicata, waiver, estoppel or pleading.

In re Pigge, supra, holds to the contrary and goes far beyond what the 1970 amendments require. The amendments seek to establish uniformity in the determination of dischargeability of debts by vesting jurisdiction in the federal court system, but that is all. They do not guarantee a creditor to a trial in the federal court system on an issue which is a pure afterthought following complete resolution of the matter in the state courts.

When petitioner argues on page 9 of the brief that *In re Nicholas, supra,* ignores the express language and purpose of the 1970 amendments, we fail to find language in the amendments to sustain petitioner's position.

On the same page of petitioner's brief, the rule of the Tenth Circuit is criticized with a comment that a creditor must pursue his fraud claim in the state courts. This is not the case. If a creditor seeks to preserve a fraud claim in the state courts he could, for example, while accepting a con-

sent judgment or default judgment on contract, request and obtain from the state court a specific ruling that while fraud has been pleaded, it is not necessary for the state court to decide that issue, and in the event of bankruptcy the matter is reserved for the bankruptcy court.

The creditor could also specifically ask that the judgment recite that fraud claims are not waived. Also, the creditor could maintain the fraud claim on the state court's trial docket as unresolved. In all events, the creditor should do something if he is serious about his fraud claim, and the first thing he should do is plead it. In no way does the Tenth Circuit's rule transfer the determination of bankruptcy discharge to the state courts.

In the case at Bar, the only reference to fraud appears in petitioner's amended answer (A. 35) keeping in mind that there were two other defendants, only one of whom filed bankruptcy. Paragraph 3 of petitioner's affirmative defenses is unclear as to who committed the alleged fraud.

In order to properly evaluate the sufficiency of this pleading, one must look to Colorado law. Rule 9(b), Colorado Rules of Civil Procedure, provides as follows:

> "(b) *Fraud, Mistake, Condition of the Mind.* In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

The leading case in Colorado as to the requirements for pleading and proving of fraud is *Morrison v. Goodspeed, et al.,* 100 Colo. 470, 68 P. 2d 458. At 68 P. 2d 462, the Colorado Supreme Court set forth the following elements:

> "The constituents of fraud, though manifesting themselves in a multitude of forms, are so well recognized that they may be said to be elementary. They consist of the following: (1) A false representation of

a material existing fact, or a representation as to a material existing fact made with a reckless disregard of its truth or falsity; or a concealment of a material existing fact, that in equity and good conscience should be disclosed. (2) Knowledge on the part of the one making the representation that it is false; or utter indifference to its truth or falsity; or knowledge that he is concealing a material fact that in equity and good conscience he should disclose. (3) Ignorance on the part of the one to whom representations are made or from whom such fact is concealed, of the falsity of the representation or of the existence of the fact concealed. (4) The representation of concealment made or practiced with the intention that it shall be acted upon. (5) Action on the representation or concealment resulting in damage. Wheeler v. Dunn, 13 Colo. 428, 22 P. 287."

It is for this reason that the Tenth Circuit in the case at Bar found that petitioner's answer does not adequately raise the issue of fraud (A. 54).

A situation in which the creditor properly pleaded fraud and obtained a consent judgment based on fraud was discussed in *In re Nadler,* 424 F.S. 1106, a 1976 decision by the U. S. District Court for the Eastern District of Missouri. In that case the bankrupts attempted to go behind the state court judgment, which was based on fraud, and to which they consented. The District Court refused to permit this, relying in part on *In re Nicholas, supra.*

Petitioner relies heavily on *In re Houtman,* 568 F. 2d 651 (9th Cir. 1978). In that case the 9th Circuit held that a state court judgment, based on fraud, is sufficient to establish a prima facie case that the debt is non-dischargeable. We do not believe the case supports petitioner's position because there the creditor fully pursued his fraud claim in the state court.

Petitioner also relies on *In re McMillan,* 579 F. 2d 289 (3rd Cir. 1978), Respondent believes this case supports his position. In that case the creditor filed a complaint based on fraud in the State Court and obtained a judgment by default. The Bankruptcy Court, asked to rely on the State Court judgment, ruled the debt dischargeable. The District Court affirmed. The Third Circuit affirmed. In the opinion it is stated that the creditor did not adequately plead fraud. The Court further stated that as between parties and their privies an issue need and should be judicially determined only once. The Court relied heavily on the fact that in a default judgment the issue was not actually litigated and thus the doctrine of *res judicata* or collateral estoppel does not come into full play. The Court undoubtedly had in mind the fact that judgments by default are subject to different rules than other judgments. They are liberally opened, corrected or vacated, and discretion is usually exercised in favor of granting such applications. These rules are fundamental and are generally discussed at 46 Am. Jur. 2d 837. Judgments, §686.

It is interesting to note that in the opinion in the case at Bar, the Tenth Circuit is mindful of the distinction between a consent decree and a default judgment (A. 53, 54). The Court refers to *U. S. v. Armour & Co.,* 402 U.S. 673 (1971). Justice Marshall said in this case:

> "Consent decrees are entered into by parties to a case after careful negotiation has produced agreement on their precise terms. The parties waive their right to litigate the issues involved in the case and thus save themselves the time, expense, and inevitable risk of litigation. Naturally, the agreement reached normally embodies a compromise; in exchange for the saving of cost and elimination of risk, the parties each give up something they might have won had they proceeded with the litigation. Thus the *decree* itself cannot be

said to have a purpose; rather the *parties* have purposes, generally opposed to each other, and the resultant decree embodies as much of those opposing purposes as the respective parties have the bargaining power and skill to achieve. For these reasons the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it. Because the defendant has, by the decree, waived his right to litigate the issues raised, a right guaranteed to him by the Due Process Clause, the conditions upon which he has given that waiver must be respected, and the instrument must be construed as it is written, and not as it might have been written had the plaintiff established his factual claims and legal theories in litigation."

In the case at Bar, petitioner waived his right to litigate fraud.

An older case is *U.S. v. Swift & Co.,* 286 U.S. 106 (1932). In referring to a consent decree, Justice Cardozo said:

"The result is all one whether the decree has been entered after litigation or by consent."

The distinction between a judgment by default and a judgment by consent is carefully analyzed in Moore's Federal Practice, Second Edition, Vol. 7, §60.19. On pages 232, 233, referring to default judgments, it is stated:

"Where timely relief is sought from a default judgment and the movant has a meritorious defense, doubt, if any, should be resolved in favor of the motion to set aside the judgment so that cases may be decided on their merits."

In referring to consent judgments, on pages 239, 240, it is stated:

"In general, a party will not be granted relief from a consent judgment; but the facts and circumstances

of a particular case may, however, warrant relief therefrom."

Notably, in petitioner's brief, on page 11, petitioner is not mindful of this distinction and refers to default judgment or stipulated judgments as the same thing. Since *In re Nicholas,* supra, was based on a default judgment, the case at Bar is substantially stronger than *In re Nicholas,* supra.

It has generally been the policy of the law to discourage multiple suits on the same issues between the same parties. It has also been generally the policy under the bankruptcy statutes to give people a fresh start and be free of their debts. The law generally does not favor afterthoughts and the taking of inconsistent positions. All of these broad generalities mitigate against the petitioner in this case who conducted litigation from June 1975 until December 1975 in the state court, at which time a consent judgment was entered in paragraph 1 on plaintiff's complaint and in paragraph 2 on Brown's cross-claim (A. 42), with no reference at all to the affirmative defense here relied on by petitioner. As a matter of policy and common sense, this creditor should not be permitted to raise a new issue as if the state court case never existed.

CONCLUSION

The judgment of the Court of Appeals for the Tenth Circuit should be affirmed.

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IN THE
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v.

MARK PAUL FELSEN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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OCTOBER TERM, 1978

NO. 78-58

G. GARVIN BROWN, III,

Petitioner,

v.

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REPLY BRIEF FOR THE PETITIONER

ARGUMENT

While Respondent's brief accurately recites the position of the Tenth Circuit in *In re Nicholas,* 510 F.2d 160 (10th Cir.), *cert. denied,* 421 U.S. 1012 (1975), this does not make its rationale any more persuasive. Respondent conjures up a bevy of so-called solutions available to a creditor in State Court if he wishes to preserve the claim of nondischargeability for a later determination in Bankruptcy Court.

None of these solutions can or should alter the consideration that the Bankruptcy Court shall give to the issue of dischargeability. The elements of fraud to be pleaded in State Court, which Respondent has detailed for this Court, are not the same as those for nondischargeability under the Bankruptcy Act. Conspicuously absent from Respondent's description of fraud in Colorado is the intent to deceive, which is the gravamen of a nondischargeable debt. Under no circumstances would this element be raised in a State Court proceeding even if fraud were the exclusive claim, and the State Court judgment and record will not, and indeed cannot, make a determination of this. Dischargeability is a federal question not a state question. The elements of the claims of dischargeability and fraud are not mere copies, and the State Courts have no jurisdiction to consider the issue of dischargeability.

There is no question that the Bankruptcy Court must consider the issue of dischargeability of a debt. The question is whether they are bound by the State Court judgment and record where there is no need to raise the issues of fraud and dischargeability. Form alone should not prevent an inquiry into the presence of fraud. The point of inquiry under § 17a (2) of the Bankruptcy Act is not in what form is the debt now evidenced, but how was the debt created? The defrauded creditor should not be penalized for taking the simplest road to judgment. The fact that a claim has been reduced to judgment should not preclude the Bankruptcy Court from inquiring into the nature of the debt underlying it where such inquiry may disclose the "rot of fraud".

Respondent claims that such a review *de novo* by the Bankruptcy Court means an abolition of the doctrines of *res judicata* and collateral estoppel. But this is not the case. The judgment and record here, and in similar cases, show not that a court already considered and passed on certain

issues, but rather that there was no consideration of the issues that the words of Section 17a give rise to. Professor Cowans has stated:

> "It seems possible to interpret the new law as meaning that if a non-bankruptcy court has made a determination as to factual issues essential to determining the dischargeability of a debt and has used the standards applicable under Section 17 in a case in which the issue was really contested before it, the determination should not be disregarded. Anything less than that such as a default, a failure to plead a discharge, a failure to consider the matter, a lack of appropriate findings of fact or other lack of clarity in what the court did should not result in the application of the doctrines of res judicata or collateral estoppel." Cowans, *Bankruptcy Law and Practice,* § 433, 1972 Supp. p. 104.

Respondent also suggests that a distinction should be drawn between a default judgment and a consent judgment for the purposes of a Bankruptcy Court review. The Tenth Circuit, however, has drawn no such distinction. In *In re Nicholas, supra,* the New Mexico State Court judgment at issue was a default judgment, while here, the State Court judgment reviewed by the Tenth Circuit was a stipulated judgment. The outcome was the same in both instances. Even though the courts have drawn distinctions between consent and default judgments in some circumstances, this is not the case in bankruptcy decisions. Respondent implies that because it was a stipulated judgment, Petitioner could have as part of the negotiations insisted on the inclusion of findings or terms covering the problem faced here. Respondent apparently ignores the well settled rule that advance agreements which waive the benefits of a discharge are void. *Fallick v. Kehr,* 369 F.2d 899 (2d Cir. 1966). The parties thus could not effect a binding agreement regarding

the nature of this debt, and therefore its dischargeability, as part of the stipulated judgment.

The approach suggested by Respondent, that the parties be bound by State Court judgments, will cause grave problems to debtors, the very problems the 1970 Amendments were adopted to cure.

CONCLUSION

For the reasons set forth herein and in the Brief for the Petitioner, the judgment of the Court of Appeals should be reversed.

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